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TO REVIEW SBA'S BUDGET AUTHORIZATION FOR FISCAL YEAR 1983

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

TO REVIEW SBA'S BUDGET AUTHORIZATION FOR FISCAL YEAR 1983

FEBRUARY 23, 1982

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

93-176 O WASHINGTON : 1982

S721-9

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TO REVIEW SBA'S BUDGET AUTHORIZATION FOR FISCAL YEAR 1983

TUESDAY, FEBRUARY 23, 1982

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in room 424, Russell Senate Office Building, Hon. Lowell Weicker, Jr. (chairman of the committee) presiding.

Present: Senators Weicker, Hayakawa, D'Amato, and Levin.

Also present: Robert J. Dotchin, staff director; R. Michael Haynes, chief counsel; Brian F. Hartman, financial analyst; Alan L. Chvotkin, chief counsel, minority; and Dorothy C. Olson, clerk.

STATEMENT OF HON. LOWELL WEICKER, JR., A U.S. SENATOR FROM THE STATE OF CONNECTICUT, AND CHAIRMAN, COMMITTEE ON SMALL BUSINESS

Senator WEICKER. The Small Business Committee today will hear testimony on the proposed cuts in the Small Business Administration's fiscal year 1983 budget.

Let me say at the outset that I have some serious concerns about the reductions proposed by the administration, which makes me probably the 100th Senator who has said that, in addition to the 435 Congressmen who have said it.

The major changes presented to us in this plan involve a significant reduction in SBA's role of providing financial and management assistance to small business. Of particular concern are the across-the-board cuts in the guaranteed lending program. This is a program which clearly is not a handout or a giveaway. It is a program which, over the years, has proven to be a major source of new jobs and new economic life, and yet we are told that these programs must be cut back. Indeed, when we look at the 5-year budget projections for SBA, we see that the administration plans to eventually reduce the program level to about $1 billion, a 75-percent reduction from the $4 billion level the program has been operated at in recent years.

Business failures are now at their highest level in 40 years, and it pains me to say that small businesses account for the major part of that sorry statistic. Every day, small businesses, unable to cope with sky-high interest rates and a lack of operating capital, are going down the tubes. I will tell you, frankly, I am afraid that if this trickle-down theory ever does take effect, there will not be many small businesses left for it to trickle down to.

This is the time when the Government should be increasing its aid to small business, not decreasing it. The guaranteed lending program is a perfect place to start. Guaranteed loans to promising small businesses are really an investment that regularly provides returns, not only to the business but to the entire community, in the form of new jobs and economic revitalization.

It is for this reason that I have vowed to oppose any further cuts in SBA guaranteed lending. Thus forewarned, I invite our witnesses to go ahead with their testimony.

Let me say this, though: That having been opposed to this economic game plan since its inception, not just the latest portion, and having just returned from the State of Connecticut where I have been for the last several weeks, the situation out there can best be termed a disgrace. The economic devastation that is being wreaked upon small business people is a bitter testament to this economic game plan.

We already have the contest of the administration on the industrial revenue bonds; now they are going after the guaranteed lending program. I could just go point by point down the administration's game plan to show the devastation it has caused. Then I have to ask the question just exactly what it is that this administration has in mind for small business. My own feeling is that after we get through with this exercise, it will be to the detriment of the free enterprise system; and it will take years to once again build up a small business community to the point where it can enter the economic mainstream and once again provide competition, innovation, and jobs.

In other words, what I am saying is, I think we are going to be left not only with small business flat on its back but you are going to end up with a few corporations owning everything. Now, if that is what this Nation is to be all about, then this is the perfect economic game plan for it. But I refuse to believe that that is our national objective, or that we should pay the price by sacrificing the benefits of industrial revenue bonds, guaranteed lending programs, and management assistance. We have spent years around here trying to change the Small Business Administration from only a lending agency to one that actually gives beneficial consultation, advice, and assistance to small business. Now that seems decimated.

I am afraid that the administration is so enthralled with a bottom-line figure that it is to the total exclusion of the impact that bottom-line figure has on the flesh and blood of this country. This is no longer a matter of philosophy. It is no longer a matter of, "I'm liberal, they're conservative," or "I'm moderate, and they're way out." This is great conversation here in Washington, D.C., and it might make good copy in the media, but that man out in the street right now has to suffer from this ideological pursuit. I am going to blow the whistle, insofar as that portion of our society is concerned that comes under the aegis of this committee. It is no longer what I think; it is what I know is happening. Believe me, that does no credit to anyone in this room, whether in the executive or the legislative branch.

[The prepared statement of Senator D'Amato follows:]

STATEMENT OF HON. ALFONSE M. D'AMATO, A U.S. SENATOR FROM THE STATE OF NEW YORK

No one doubts that, in budgetary affairs, 1982 will be another year of restraint. Faced with the possibility of a Federal deficit in excess of $100 billion dollars, we must make substantial cuts in Government programs. The question, of course, is one of priorities, which programs are to be cut? Which are to be preserved? And, if a decision to cut a particular program is made, just how extensive should these cuts be?

The administration's proposed 1983 budget has identified the Small Business Administration as a target of deep cuts. Direct loans have been all but eliminated for fiscal year 1982, the Congress authorized $230 million and appropriated $225 million in direct loans. Now the administration is requesting only $41 million in direct loans for 1983. Furthermore, the administration has earmarked this entire $41 million for minority enterpise loans. Direct energy loans, direct handicapped loans, and every other type of previously direct SBA loan has been completely eliminated from the budget. This 81.8 percent cut in the SBA direct loan program is a larger proportional cut than can be found almost anywhere else in the proposed budget.

Guaranteed loans are also slated for drastic cutbacks. For fiscal 1982 the Congress both authorized and appropriated $3.3 billion in guaranteed loans. For fiscal 1983 the administration is requesting only $2.4 billion in guaranteed SBA loans. This is a 27.3 percent cut in a single year.

Out-year projections by the administration project an even deeper cut in SBA guaranteed loans, to a mere $1.15 billion by fiscal year 1987. This represents an additional 52.1 percent cutback over proposed fiscal 1983 levels.

The proposed 1983 budget calls for a SBA staff reduction of 220 positions, 5.5 percent, from 4,036 to 3,816. A disproportionate share of this staff reduction, 90 positions, will come from the vital management assistance program.

Another cut is a 40-percent reduction from $250 to $150 million in the small business pollution control financing program. In addition, a new restriction is added. The SBA will no longer be able to quarantee any loans under this program if financing for the project involves tax-exempt issues such as industrial development bonds. This virtually kills this enormously successful program. To this date, no such project under this program has ever used anything other than tax-exempt financing. Firms such as the Norlite Corporation of Cohoes, New York, need this assistance if they are to meet Federal EPA pollution control standards. Without this assistance, small businesses faced with expensive pollution control projects might just as well shut down. We can not allow this to happen.

In my opinion, this committee is going to have to take a very careful look at the proposed SBA budget before agreeing to any of these cuts. Small businesses comprise the very backbone of this Nation. They already are at a very great disadvantage in the marketplace. We can not—and should not—worsen their situation.

Senator WEICKER. The first witness is Mr. Donald Templeman, Acting Administrator of the Small Business Administration. Mr. Templeman, you may proceed.

STATEMENT OF DONALD R. TEMPLEMAN, ACTING ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY EDWIN T. HOLLOWAY, ACTING ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT; AND HARRY S. CARVER, CONTROLLER

Mr. TEMPLEMAN. Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before this committee to discuss the administration's 1983 budget request for the Small Business Administration. With me today are Edwin T. Holloway, Acting Associate Administrator for Finance and Investment, and Harry S. Carver, Controller.

Mr. Chairman, we consider SBA's budget request to be consistent with the best interest of the Nation's small businesses. In talking with a wide variety of small business people in different business classes and from all geographic regions of the United States, it has become increasingly obvious to me and my colleagues that the top

priorities for small business owners are: Improved access to private credit, reduced interest and inflation rates, stable financial markets, regulatory reform, and tax reduction.

SBA, in its role as the Nation's advocate for small business, continues to speak out on these issues and endeavors to insure that small businesses are well represented when Federal policies in these areas are determined. Through our agency's partnership with private sector financial institutions, we are encouraging private small businesses in establishing good working relationships with private sector institutions. Whether through our certified lenders program, minority enterprise small business investment company assistance, small business investment company assistance, or development companies or sureties, this agency is leveraging private sector capital and expertise with Federal resources to assist the small business community.

Most importantly, however, Mr. Chairman, SBA willingly participates in the administration's efforts to bring excessive Federal spending, deficits, and market involvement into perspective. Moreover, we believe that SBA can make a significant contribution to the economic recovery program without significantly retarding our efforts to achieve the agency's mission of assisting the Nation's small businesses.

This can be accomplished by using a number of vehicles, including: Strengthening the management and control of agency programs and support functions, improving management systems, limiting credit assistance to valid cases of unavailability of credit from conventional sources, and improving the quality of loans approved, combined with intensifying our emphasis in the area of debt collection. Debt collection is important not only from a fiscal perspective, but is necessary to overcome any erosion of confidence in the agency's ability to manage its lending programs and prevent losses.

Mr. Chairman, it is important to note here that most of the management initiatives that I have just mentioned are already in the process of implementation—not just to get into line with budget reductions, but because they are, and have been for some time, necessary for the Small Business Administration to effectively accomplish its mission.

In the final analysis, it is the success of this administration's economic policies which allow us to address the small business priorities I mentioned above.

A major component of the administration's overall program for economic recovery is to reduce Federal intervention in the Nation's financial and credit markets. Consistent with this goal, SBA determined that, with the exception of purchasing preferred stock and debentures in MESBIC's, we would request no funding for direct loans in fiscal year 1983.

This is, of course, a major shift in agency operations. It should not, however, be viewed as contrary to the best interests of the small business community. This committee is very familiar with the history and operation of SBA's direct lending programs. You are familiar with the difficulties associated with establishing acceptable loss rates and other parameters for these programs, and with the inordinate resources which the agency has devoted to loan

making. Additionally, SBA has always had the problem of allocation of scarce direct loan resources among competing interests. Attempts to utilize various alternative methods of allocation always have resulted in giving one group or business a competitive advantage to the detriment of other small firms.

Mr. Chairman, I recognize that there may be small firms operating today who would not be in business without the assistance provided by an SBA direct loan. However, in a time of budget restraint, those funds leveraged through private sector lenders could provide assistance to a far greater number of businesses, at much lesser cost in terms of the agency resources required to administer the programs. Through increased cooperation with private sector financial institutions, as I have outlined above, we hope to still assist those businesses that have a reasonable prospect for success.

By eliminating funding for subsidized direct loans, and thereby eliminating another type of market intervention, SBA can turn its attention to other initiatives. Certainly, limiting Federal credit assistance will cause the amount of available private credit to expand, and will contribute to a reduction in interest and inflation rates. Consistent with this administration's policy, we also are recommending a reduction in the level of guaranteed lending.

Seventeen percent—approximately $410 million—of SBA's guaranteed loans in 1983 will be made available for firms owned by socially and economically disadvantaged individuals, as compared with an average over the past 5 years of 9 percent minority participation in the agency's guaranteed loan programs, and 12.8 percent minority participation in all the agency's loan programs, including direct and guaranteed.

Also, Mr. Chairman, the certified development company program continues to certify the 503 companies, thereby increasing the private sector share of small business lending in this program which seeks to create significant additional employment.

Clearly, SBA's contribution to the effort to reduce Federal intervention in the credit market will not be undertaken at the expense of those who are most in need of the financial assistance that the agency can provide—the victims of market imperfections and discrimination.

While it is important to make sure the committee understands our reasons for reductions in financial assistance programs, it is even more important that you recognize our commitment to improving the delivery of nonfinancial assistance to small business, with greater emphasis on cooperation with non-Federal Government delivery mechanisms.

We believe that we can continue to deliver optimal levels of nonfinancial assistance to the small business community at the funding levels requested in the budget, and we believe that we can do so more effectively and efficiently than ever before. We do not believe that the proposed personnel reduction will prevent us from maintaining current delivery levels. Management improvements and increased private sector involvement and participation are expected to close the gap of funding reductions.

Additionally, in the area of small business contracting with the Federal Government, this agency, with the statutory support of Public Law 95-507, is having a tremendous impact on the small

business community. We have recently completed negotiations with Federal agencies on small business procurement goals for fiscal year 1982. If agencies achieve these negotiated goals, small businesses will receive $3 to $3.5 billion more in Government contracts in fiscal year 1982 than in 1981. This should push the total amount of Federal procurement dollars going to small businesses over the $40 billion mark in this fiscal year. These contracting dollars provide real income and have a substantially greater impact on the health of the small business community than providing additional debt capital.

Mr. Chairman, let me assure you that the Small Business Administration will continue to be the Nation's primary and strongest advocate for small business; that the Small Business Administration will continue in its efforts to assure that small business receives its fair share of Government procurement; that the Small Business Administration will continue to provide necessary financial and management assistance to the Nation's small business community; and that the Small Business Administration will continue to be an effective tool for minority business development.

With improved management and administration of these responsibilities, we firmly believe that SBA will become a better advocate, counselor, lender, and business developer, even at these reduced funding and personnel levels.

In conclusion, Mr. Chairman, we believe that the budget request for the Small Business Administration which you have before you is reasonable. Moreover, we believe that we can improve the quality of our service to America's small business community in fiscal year 1983.

Most importantly, however, we feel that small business on the whole in this country will benefit more from our contribution to stable financial markets, interest and inflation rate reductions, and limiting Federal credit assistance than from our efforts to assist a necessarily limited portion of this number through increasing programmatic outlays. We support the basic tenets of the administration's economic recovery program, and we believe that we can effectively and efficiently accomplish the mission of the Small Business Administration at the funding and personnel levels proposed.

Mr. Chairman, I wish to again express my appreciation for your invitation, and for providing the opportunity to appear here today. I will answer, to the best of my knowledge and ability, any questions that the committee wishes to ask.

Senator WEICKER. I would like to go over your statement. I have some other questions here, but let us start with this one.

On page 3 of your statement, you say: "This can be accomplished by using a number of vehicles, including strengthening the management and control of agency programs and support functions," and so on. Why should this committee give any credence to that statement, when you people do not even have your own management in order?

I find it absolutely incredible, as the chairman of the committee who willingly supported the choice of this administration, even though it became obvious at the outset that the President himself had no knowledge of his own administrator—that he had never

met him; he didn't even meet him after he announced his nomination—and here, a year later, he is moved aside.

When I hear about "better management of agency programs," I can only think that the agency's own management is in an uproar at this stage of the game.

Mr. TEMPLEMAN. I do not believe that I am in a position to answer for all the reasons that the administration chose to remove Mr. Cardenas. I do believe that while he was there great progress was made in many SBA programs. For instance, in the 8(a) program, I think we have made more progress than in the 10 years prior. I think we made progress in some of the financial programs. I think many good things went on. There is some disruption at SBA, there is no doubt of that, because we do have a new Administrator on the way.

However, I believe that these accomplishments during Michael Cardenas' tenure will continue and, in fact, will do the agency well for several years. I really do believe we have made progress in the management of many of our programs.

Senator WEICKER. In your statement, you say on page 5, after you get through eliminating funding for direct loans, then SBA can turn its attention to other initiatives. You say, "Consistent with this administration's policy we also are recommending a reduction in the level of guaranteed lending." Then you go on to advocate, "improving the delivery of nonfinancial assistance" at the same time you are proposing cutting the nonfinancial assistance by 96 people and some $6 million. And finally, you come around to the point that you are interested in the cooperation of non-Federal Government delivery mechanisms.

I do not think I need the administration to tell me, and I don't think the small businessman needs the administration to tell him what is available to him in the way of non-Federal assistance.

If you eliminate the direct loan program, if you eliminate or greatly reduce the guaranteed lending program, if you decimate the management assistance program, and then when you hold out to the committee a concept of "non-Federal sources" that are going to step in here and do the job, what does all of this mean? Why not eliminate the agency?

Mr. TEMPLEMAN. I believe that the management assistance program, by the change in people, reflects, rather than a decimation of the service, a change in their role. We at SBA for several years have not had enough people in management assistance to do all of the counseling and all of the training, certainly, that the small business community needs.

Senator WEICKER. I beg your pardon?

Mr. TEMPLEMAN. I say, for years there have not been enough people to do all of the counseling and training that the small business community needs, nor do I think it will attain that number of people. I believe that we can serve the function better with fewer people, as a matter of fact, by coordinating the efforts of people that are there, such as accounting societies and local chambers of commerce. We have begun this private-sector involvement, and we have had very good response from a number of organizations that have not heretofore been organized to help small business. The total amount of assistance to small business in the management

area, I believe, will stay the same or possibly improve, even with the reduced people.

Senator WEICKER. Then finally, on page 8, you state, "We feel that small business on the whole in this country will benefit more from our contribution to stable financial markets, interest and inflation rate reductions * * *" Now, aside from the fact that inflation might be coming down, for whatever the reason, most people feel we are in a recession. Ask the small businessman just how much he has had in the way of interest rate reductions. Ask him about the stable financial markets.

I think a lot of people are perfectly in agreement that small businessmen are willing to sacrifice, even in terms of bottom-line profit, if indeed there is hope for the additional availability of capital, low interest rates, mobility in the market, et cetera. None of that has come to pass. Yet many small businessmen have made the ultimate sacrifice: They are out of business.

Gentlemen, before I get to the questions prepared by my staff—and then I will let Senator D'Amato and Senator Hayakawa ask any that are on their minds—I would like to emphasize, as I did throuthout the Carter administration, and as I have done during this administration, that I expect the Small Business Administration to be the advocate for the small business community, even if that means voicing differences relative to administration policy, as that policy particularly impacts on the small business community.

Now, the administration's economic policy might be great for some. However, it is not the purpose of this hearing to get into a general overview of that policy. But I do know that this policy is not great for small business, and I know that somebody had better be out there advocating their particular problems. Indeed, this is a Greek chorus for the administration's economic policy which, for whatever else it has done, has not helped small business.

The statistics are on my side. Mr. Templeman, have you read the statistics as to how many small businesses are going belly-up?

Mr. TEMPLEMAN. Yes, I have. We are as concerned as you are with that.

Senator WEICKER. You have a job, and I have one. We can rub our hands in grave concern, but these people are out. They are through. Now, at what point do we say the plan is not working?

Mr. TEMPLEMAN. Well, I certainly am not to the point of saying that the plan is not working. I think there is some evidence where even interest rates have come down in the last year. I assure you that within the administration we advocate very strongly—and "advocate" is a polite word—at higher levels of the organization in the interests of small business. We are not always successful; sometimes we are. But we are there trying to do exactly what you are saying.

Senator WEICKER. I will ask one question, and then I will yield to Senator Hayakawa. The question is: The SBA budget estimate for fiscal year 1983 calls for total SBA guaranteed business loans to be cut $900 million, from an authorized total level of $3.3 billion in fiscal year 1982 to $2.4 billion. In nominal dollars, this is a cut of more than 27 percent. Adjusting for the 6.9-percent rate of inflation the administration projects for fiscal year 1983, this is a real cut of almost one-third.

Furthermore, the administration has noted on page 212 of its "Major Themes and Additional Budget Details for Fiscal Year 1983 Publications": "The total SBA guaranteed loan commitments will fall from $3.616 billion in 1981 to $1.150 billion in 1987." This is a nominal cut of more than 68 percent. Adjusting for the administration's inflation forecast, this represents a real cut of more than 75 percent.

On the one hand, the administration's revised budget results in record-high deficits, which everyone except the administration believes will push interest rates up even higher and make capital even more scarce, and on the other hand, at the same time, the administration is cutting by one-third in fiscal year 1983 and by three-quarters by 1987 an important source of capital for the small business community. I would like to hear your justification for this one-two punch.

Mr. TEMPLEMAN. Let us start with the out years first, the years beyond fiscal year 1983. We certainly do not consider those as a conscious policy decision at this point. Those are figures, primarily budget projections, and we at SBA consider them to be, frankly, OMB's efforts to show a balance or to get their out years——

Senator WEICKER. That is what you figure at SBA, but I will tell you, this is not some columnist writing his opinions. This is the President of the United States speaking, and I think we should all put a fair credence that when the President says something he is not kidding.

Mr. TEMPLEMAN. It is an ominous thing for the guaranteed program; there is no doubt about that. What I am saying, however, is that we do not intend to abide by those without doing exactly as you were saying earlier: advocating for different levels, depending on the economic conditions at the time. We are not taking these as given, that we cannot resist this and get some change. We are not locked in that tight as an agency to those years.

The fiscal year 1983 budget is a different situation. Clearly, there is obviously a reduction. But we do feel that as the President's economic recovery program begins to take hold, these things will happen; and as they do, much of that difference will be made up by the private institutions. Certainly, there is always the concern that the economic level is related to this.

At the current time, we do not have this kind of demand, even in our loan programs, because of the economic conditions and because of the high interest rates. As economic conditions improve and interest rates drop off, obviously our demand will increase. We believe that the private sector will pick up the difference. It if does not, then we have another situation to go back to OMB with.

Senator WEICKER. Senator Hayakawa?

Senator HAYAKAWA. I just have one question to ask. What is the future of the SCORE program under your budget?

Mr. TEMPLEMAN. The SCORE program is one of those private-sector areas that we will be depending more on in the future. SCORE has undergone somewhat of a change, in terms of its organization, in terms of its training. It is a very vital part of the Small Business Administration's outreach effort in management assistance.

Senator HAYAKAWA. That has been my impression. It would be enlarged, with a smaller budget?

Mr. TEMPLEMAN. The total number of individuals in the SCORE program may not be enlarged. However, we have many that are registered that are not active, that are not trained in the more modern techniques. We intend to improve their capabilities, to bring them up to date, and to utilize a greater portion of those that are actually on the rolls.

We have combined the SCORE—Retired Executives—with ACE—Active Corps of Executives—to aid in updating skills and expertise in the SCORE program. ACE volunteers are men and women still active in business who volunteer to counsel small business.

Senator HAYAKAWA. Are SCORE programs found in every major- and middle-sized city in the United States?

Mr. TEMPLEMAN. Yes, sir. I believe that is true.

Senator HAYAKAWA. About how many do you think are enrolled?

Mr. TEMPLEMAN. Between 8,000 and 9,000. It varies from day to day, but it is around 8,000 or 9,000.

Senator HAYAKAWA. Let us say in San Francisco: How many people there?

Mr. TEMPLEMAN. There are 3 chapters with 139 SCORE and ACE volunteers.

Senator HAYAKAWA. Take any city.

Mr. TEMPLEMAN. It varies. For instance, in Los Angeles, there are 7 SCORE chapters and 266 people. They drift in and out, based on their own needs. Being volunteers, you know, their needs change.

Senator HAYAKAWA. In Los Angeles you have about 50 to 60?

Mr. TEMPLEMAN. Yes.

Senator HAYAKAWA. Does SBA actively go out to recruit these people? How do these people find out there is such a program?

Mr. TEMPLEMAN. We help to promote the SCORE chapter. Once it is established, the SCORE chapter promotes itself, in effect.

Senator HAYAKAWA. You mean to say, that the people who belong to SCORE constitute a chapter?

Mr. TEMPLEMAN. Yes; nationally there are approximately 400 SCORE and ACE chapters.

Senator HAYAKAWA. They have meetings, and presumably they make their own rules?

Mr. TEMPLEMAN. Yes, sir. It is a little bit of a social organization for some of these people. They do spend time there. In the past, it has been a situation where they have not been required to spend any amount of time. In the future, we will be looking for some minimum commitment from them, because certainly we want some tool there to help small business rather than a social club for retired people. As part of their application, the SCORE volunteer agrees to work a stated length of time which has been established by the associate district director for management assistance and the volunteer. The volunteer also serves a provisionary 90-day period before they are accepted into the program. Both of these requirements are new.

Senator HAYAKAWA. Of course. Has it been an effective program in the past?

Mr. TEMPLEMAN. Yes, it has. Its effectiveness varies by the chapter. It varies by the types of individuals that happen to be in there currently. It is an effective program, but it certainly can be made more effective.

Senator HAYAKAWA. Has it been a lot of help to minority businesses, for example?

Mr. TEMPLEMAN. I doubt that it has been of as much help to minority businesses as it should be. One of the problems we have in SCORE is, quite frequently, it is made up of retired individuals from rather large companies, and they do not deal necessarily in the kind of small business concerns that especially a minority company needs to deal with.

Senator HAYAKAWA. There should be retired minority businessmen in SCORE too, shouldn't there?

Mr. TEMPLEMAN. There should be, and we will be recruiting retired small business individuals. One of the things is that a small business person does not retire as early as a large business person, because of a lack of formalized retirement plans.

Senator HAYAKAWA. Thank you, Mr. Chairman.

Senator WEICKER. Thank you very much, Senator Hayakawa.

Senator D'Amato?

Senator D'AMATO. Mr. Templeman, were your staff or you consulted in the preparation of this budget?

Mr. TEMPLEMAN. Yes, sir.

Senator D'AMATO. What was your attitude, for example, on some of the cuts proposed? Let us talk about the direct loan program, where the proposal is to cut it from $225 million, which was appropriated following an authorization of $230 million, down to only $41 million, with that $41 million in direct loans solely for minority enterprises. What was your reaction in terms of eliminating direct energy loans, direct handicapped loans, and other previously authorized loans?

Mr. TEMPLEMAN. We agree that the direct loan program should be eliminated.

Senator D'AMATO. You do?

Mr. TEMPLEMAN. Yes.

Senator WEICKER. Would the Senator yield on that point?

That includes the $15 million to the handicapped?

Mr. TEMPLEMAN. Yes.

Senator D'AMATO. Direct energy loans?

Mr. TEMPLEMAN. Yes.

Senator D'AMATO. There is no benefit from this program?

Mr. TEMPLEMAN. There are benefits to some of these programs—certainly the handicapped and energy loans. It is the feeling, however, that in the overall effort to reduce the budget, to get the Government out of the credit market, that some good programs go with some that are not so good.

Senator D'AMATO. What about energy? Has energy conservation proved effective?

Mr. TEMPLEMAN. I do not know. Possibly Mr. Holloway could answer better on the specifics of what the results of what the energy loan program have been. I am not familiar with any results studies.

Mr. HOLLOWAY. Senator, the energy loan program, as well as some of the other direct loan programs, we felt could be better attacked by leveraging private-sector resources and using the guarantee route rather than the direct route.

Senator D'AMATO. What about the cuts in guaranteed loans? I mean, it is nice to say "use the guaranteed route," but if we are going from $3.3 billion in guaranteed loans to only $2.4 billion, which is a 27.3-percent cut, what are we talking about? You didn't ask us to increase guaranteed loans; you asked us to cut guaranteed loans.

Mr. HOLLOWAY. That's correct, Senator. Actually, for the present fiscal year that we are in, even though we have proposed a lesser amount, around $2.7 billion, our rate of approvals, because of the current conditions of the economy, are running probably only around 50 percent of that level demand. The demand is not out there now, either in Government-guaranteed lending or in non-SBA lending with the banks at these interest rates and at these rates of inflation. The current environment is an environment in which people who can defer borrowing do defer borrowing.

Senator D'AMATO. I notice with some dismay that there is a 40 percent reduction—$250 to $150 million—in the small business pollution control financing program. In addition, the SBA will no longer be able to guarantee any loans under this program if the financing involves tax-exempt issues, such as industrial revenue bonds. Now, doesn't this really just kill this program, as a practical matter?

Mr. TEMPLEMAN. That is really yet to be seen, Senator. We went to all of the people who had applications pending before the administration with letters inviting their response as to whether or not they would wish us to pursue attempting to assist them under the regular taxable guarantee program.

Senator D'AMATO. I would hate to have you be my advocate. If the SBA is supposed to be an advocate for small business, we are in big trouble.

Mr. Chairman, I would like to put my statement, as if read into the record.

Senator WEICKER. The Senator's statement will be placed into the record in its entirety at the conclusion of the testimony of these witnesses.

I would come back to one point that Senator D'Amato raised on the direct loan program. As I understand it, the Small Business Administration has always been perceived as the lender of last resort for small businesses who can't get loans elsewhere. I do not understand, for example, in terms of the $15 million for the handicapped—are these people going to be OK out there? Everything is all right in the private financial markets for them?

Mr. TEMPLEMAN. Certainly I would not say that everything is all right for handicapped people in the financial market. The interest rate difference between the 3 percent that was available under SBA and current financial rates makes a tremendous amount of difference in economic decisions for anyone. Again, it is a matter of eliminating segments of our programs that we feel overall are necessary in order to bring our agency in line with the President's plans.

Senator WEICKER. If anything emphasizes the brutality of this operation, that little item makes the point.

I understand that at the present time there are direct loan funds available through SBA; is that correct?

Mr. TEMPLEMAN. Yes, sir.

Senator WEICKER. At the same time, I understand there are waiting lists at some field locations for SBA direct loans. In addition, during the first quarter of fiscal year 1982, the total dollar volume of guaranteed SBA loans was down almost two-thirds from the same period in fiscal year 1981. It is not consistent with a strong, upward trend in business loan demand during the first quarter of 1982.

First, why are there waiting lines for direct loans?

Mr. TEMPLEMAN. I believe there was some misunderstanding in some of the offices about once they got their loan allocation that they couldn't ask for more. We have since corrected that and have instructed all of the regional offices that there are funds available; and that if their particular allocation is nearing the point where they see they will be out of money, they should come to us and we will reallocate from regions that are not using all of their direct moneys.

Senator WEICKER. You have so notified the Hartford office?

Mr. TEMPLEMAN. Yes, sir.

Senator WEICKER. Second, why has the dollar volume of SBA guaranteed loans dropped off so dramatically when there is an obvious need and demand for those funds?

Mr. TEMPLEMAN. I do not believe that the demand is quite that obvious, Senator. We are not restricting SBA direct loans. With the interest rates that direct loans are at now, it just is not there.

Senator WEICKER. I have further questions that will be submitted to you for the record, Mr. Templeman.

[Subsequent information was received and follows:]

LOWELL P. WEICKER, JR., CONN., CHAIRMAN
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S. I. HAYAKAWA, CALIF.
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R. MICHAEL HAYNES, CHIEF COUNSEL
ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

February 23, 1982

Mr. Donald R. Templeman
Acting Administrator
Small Business Administration
1441 L. Street, N.W.
Washington, D.C. 20416

Dear Mr. Templeman:

As I stated at the hearing on the SBA Budget for FY 1983, the Committee would submit additional questions to the Agency to be answered. These questions are enclosed.

Please respond with answers within the next ten days.

Sincerely,

Lowell Weicker, Jr.
Chairman

Enclosures

MH/nm

Honorable Lowell Weicker
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are the responses to the questions you asked relating to the Small Business Administration's budget for 1983 from the February 23 hearing.

If we may be of further assistance to you regarding the budget, or any other small business related issues, please contact our Congressional and Legislative Affairs Office.

Sincerely,

Marshall J. Parker
Assistant Administrator for
External Affairs

Enclosures

INFORMATION REQUESTED AT THE 1983
SENATE BUDGET HEARINGS

Questions & Answers

GUARANTEED LENDING PROGRAM REDUCTIONS

The SBA budget estimate for FY 1983 calls for total SBA guaranteed business loans to be cut $900 million, from an authorized program level of $3.3 billion in FY 1982 to $2.4 billion. In nominal dollars, this is a cut of more than 27 percent. Adjusting for the 6.9 percent rate of inflation the Administration projects for FY 1983, this is a real cut of almost one-third.

Furthermore, the Administration, as noted on Page 212 of its Major Themes and Additional Budget Details for FY 1983 publication, is calling for total SBA guaranteed loan commitments to fall from $3.616 billion in 1981 to $1.150 billion in 1987. This is a nominal cut of more than 68 percent: but, adjusting for the Administration's inflation forecast, this represents a real cut of more than 75 percent!

On the one hand, the Administration had devised a budget that will result in record high deficits which everyone, except the Administration, believes will push interest rates up even higher and make capital even more scarce. On the other hand, at the same time, the Administration is cutting by one-third in FY 1983 and by three-fourths by 1987 an important source of capital to the small business community.

QUESTION: How is this one-two combination to the small business community justified?

ANSWER: In considering reduction in the authorized program level from approximately $3.3 billion in FY 1982 to $2.4 billion in FY 1983, we believe such a reduction is reasonable and manageable based upon two principal factors:

(1) For the first four months of FY 1982 loan demand is running at just under 40 percent of FY 1981 level. At this rate of usage, it would appear that in 1982, total guaranteed loan volume will not reach a level of $2 billion.

(2) With the emphasis placed upon redirection of Agency lending practices toward "reasonable assurance of repayment", it was recognized that a reduced level of loan approvals could be expected.

While a significant portion of the drop in FY 1982 lending is attributable to the current economic environment, the redirection was expected to have sufficient impact that a level of $2.4 billion would be fully adequate to provide assistance for all credit worthy applicants.

As for the out years leading to 1987, these were estimates based upon an increasing level of assistance expected of private sector institutions. It is believed, however, that final budget figures for the out years will be based upon demand more clearly identified as those final budgets are prepared.

QUESTION: With such wholesale reductions in the SBA programs, what do you see as the mission of the Agency?

Do you see the Administration's proposals as the first step in a process to get rid of the Agency?

ANSWER: The budget reductions do not represent the first step in getting rid of the Agency, nor are they of a magnitude or nature which indicates that SBA is being treated any differently than other Federal Departments and Agencies.

The proposed reductions in financial assistance programs are similar to reductions in other financial assistance programs across the government. Personnel reductions also reflect SBA's share of total government-wide reductions proposed in this area.

This Agency's mission to aid, counsel and assist small businesses will continue and we will vigorously pursue current efforts and new initiatives to ensure effective assistance will be provided to the small business community

DIRECT LOAN QUESTIONS

The SBA has always been perceived as the "lender of last resort" for small business persons who can't get loans elsewhere. We now see a recommendation that all the SBA direct lending programs be eliminated!

QUESTION: Don't you believe that SBA has a responsibility in this area as a "lender of last resort" to qualified small businesses in need of capital and financing?

ANSWER: We continue to believe that SBA has a responsibility as a "lender of last resort" to qualified small businesses in need of capital and financing. However, in a time of budget restraint, and amid efforts to provide more assistance through the private sector, we believe the limited resources of the Agency can be more effectively used in leveraging our guaranty program assistance.

QUESTION: Your dismantling of the direct lending programs, includes an elimination of $15 million in loans to the handicapped?

What is your basis for taking this position?

ANSWER: Lending under the HAL program is divided into two categories, HAL I loans go to non-profit institutions which assist or employ handicapped individuals and HAL II loans go to handicapped persons to start or expand their own businesses.

The following chart indicates the number and dollar amount of loans made in each category during Fiscal Year 1980 and through August 1981.

	Fiscal Year	# Loans	Total Amount	SBA Share
HAL I	1980	60	$ 9,660,650	$ 9,330,000
	1981	87	13,970,867	13,449,624
TOTAL		147	$23,631,517	$22,779,624
HAL II	1980	198	$10,958,515	$10,912,885
	1981	179	12,531,450	12,446,750
TOTAL		377	$23,489,965	$23,359,635

Much of the demand for these loans is due to the statutorily set three percent interest rate.

Basically, our arguments for the elimination of these funds is consistent with our argument on direct loans. Small businesses owned by handicapped individuals face problems similar to those faced by the small business community as a whole. These businesses also will not necessarily benefit from increasing what is already an over-leveraged financial situation. We will, of course, encourage financing through banks when called for, and will assist these businesses through our non-financial assistance programs.

MANAGEMENT ASSISTANCE (MA)

The Administration has recommended that SBA's MA programs be cut by $6,447,000 -- from $28,365,000 in FY 1982 to $21,918,000 in FY 1983, an absolute reduction of nearly 23 percent. In addition, under this proposal, 96 permanent MA positions -- jobs -- out of 381 will be eliminated in FY 1983, an absolute reduction in the MA workforce of more than 25 percent. Nearly all of the jobs eliminated are in the field.

Yet SBA's budget estimate (S&E, page 34) states that, "management assistance is the largest interface with the small business community consisting of almost one-half million client contacts per year. It is in the area of management assistance that both the actual and potential accomplishments with the private sector can be found."

The budget estimate goes on to state that, "the SBA's management assistance programs are designed to address the predominant cause of most small business failures -- a lack of managerial know-how."

QUESTION: At a time when 1981 business failures rose to record high levels and are getting worse, how does the Administration justify cutting -- by almost one-fourth -- its management assistance programs which are "designed to address the predominant cause of most small business failures?"

ANSWER: We simply must do a better job in managing resources, in effective utilization of personnel, and in involving the private sector. For some time now we have focused management assistance personnel on resource management rather than direct counseling and training. Any reductions in MA field staff dictates the need to prioritize outreach, training, and effective application of available volunteer, academic, and private sector resources. Our FY 1982 objectives specifically address these areas. Coupled with this approach, we are taking steps to retain the best qualified people possible in MA. We have contacted some 300 private sector organizations, and we have taken action with our volunteer resources to strengthen their management and control. These actions will, we believe, minimize the impact of the planned staff reductions.

503 QUESTION

The Section 503 program is one of the major economic development programs at the Federal level. It provides affordable capital for small business to expand their plants or buy equipment, thereby creating meaningful private sector employment.

At the end of FY 1981, SBA had granted certification to 134 development companies to issue "503" debentures. I understand that there are now 179 certified development companies (CDC). SBA rules require that in order to stay in the program, these companies must be active, i.e., make at least one loan each Fiscal Year.

Given that all of the mechanisms for processing loans for this relatively new program are all now in place, we can assume that certified development companies will be submitting more projects for funding.

NOTE: (Simple arithmetic: $150 million divided equally among 179 CDC's is approximately $800,000 per company. At a maximum statutory level of $500,000 per project this is less than 2 projects for each company.)

QUESTION: With the increasing number of companies and their likely increased use of this program, do you believe that $150 million will be adequate to meet the demand?

ANSWER: The 503 program is new and it is difficult to precisely predict the program needs. However, based on the program performance for the 15 months ending December 31, 1981, the $150 million level should be adequate for FY 1982. However, it probably will not be for FY 1983.

It should be noted that the $150 million level is for both the 503 program and 502 local development company program.

During FY 1981, there were 187 503 loans approved for $34.6 million and there were 148 502 guaranty loans approved for a total $32 million.

During the first quarter of FY 1982, there were 73 503 loans approved for $11.8 million and 15 loans for $3.9 million in 502 loan guarantees.

The average size 503 loan during the last 15 months (start up period of the program) has been $177,000. We expect that to increase to $200,000 for the remainder of FY 1982.

As of February 28, there were 183 approved CDCs and there were 47 applications in process in the Central Office. Typically, it takes a CDC 6 months to become active once approved. On that basis, we expect about 200 CDCs to process an average of 3 loans in FY 1982. Since the average size will be about $200,000, we expect the 503 program will require about $120 million. We expect the 502 program will require no more than FY 1981, or about $30 million.

Concerning FY 1983, the total number of active 503 companies probably will not exceed 250 or 300. However, their degree of activity is not known. We expect the average size debenture to increase to $225,000 or $250,000. It is likely that the program level demand could approach $250 million without considering the effect of the 502 loan program.

This increased demand could be satisfied by transferring to the 503 program authority from some other SBA guaranty loan program where demand does not appear to exist. We do not foresee requesting an increase in the overall guaranty program level to accommodate an increase for the 503 program.

LOAN AVAILABILITY

Mr. Templeman, I understand that at the present time there are direct loan funds available at SBA. At the same time, I understand that there are waiting lists at some field locations for SBA direct loans. In addition, during the first quarter of FY 1982, the total dollar volume of guaranteed SBA loans was down almost two-thirds from the same period in FY 1981. This is not consistent with the strong upward trend in business loan demand during the first quarter of FY 1982.

NOTE: It may be the Administration's intentions to make it appear as though there is no demand for SBA loans and therefore the cutbacks should not be cause for concern.

QUESTION: First, why are there waiting lines for direct loans?

- - And, second, why has the dollar volume of SBA guaranteed loans dropped off so dramatically when there is an obvious need and demand for those funds?

ANSWER: When direct loan funds, available by quarter, were allocated to our field offices around the

country, some used these funds and had additional demand. It is now apparent that many offices did not use the full amount of their allocations and there now appears to be some surplus of funds at a number of locations.

We have advised all offices that need additional funds of any kind to request them through their regional budget officers. When these requests are totalled, we shall be in a better position to match the total demand with the funds remaining and make an equitable redistribution.

The guaranty fund situation is very much different from the direct situation. Contact with our field offices leads us to believe that there has been a substantial drop off in loan demand generally. This includes demand for non-SBA bank loans. It appears very likely that despite a perceived need for funds by business concerns, those that can defer borrowing are doing so in the face of continuing high interest rates and uncertain economic conditions.

CARL LEVIN
MICHIGAN

United States Senate
WASHINGTON, D.C. 20510

February 23, 1982

Mr. Donald R. Templeman,
Acting Administrator
Small Business Administration
1441 L Street, N.W.
Washington, D.C. 20416

Dear Mr. Templeman:

Although I was unable to attend today's Senate Small Business Committee hearing during your testimony on the FY83 budget for the Small Business Administration (SBA), I wanted to pose two questions for your consideration. Those questions are attached.

Please respond at the earliest possible date.

Thank you for your cooperation and assistance.

Sincerely,

Carl Levin

CL/jfc

enclosure

1) Once Congress has enacted authorizations for commitments to guarantee and, where necessary has provided appropriations for programs under the jurisdiction of the Small Business Administration (SBA), will the SBA adhere to those congressional decisions or the unilateral decisions by the Office of Management and Budget (OMB) to restrict commitments below the congressionally determined levels?

2) Please provide me with a copy of all of OMB's FY83 Budget Guidance to the SBA, and SBA's response to that guidance, and any letters of appeal filed by the SBA contesting any budgetary decisions made by OMB that affect SBA, plus any notifications to Congress to reprogram funds. I am also requesting a copy of SBA's initial budget submission to OMB.

SBA

U.S. Small Business Administration Washington, DC 20416
Office of the Administrator

APR 2 1982

Honorable Carl Levin
United States Senate
Washington, D.C. 20510

Dear Senator Levin:

This is in reply to your letter of February 23, 1982 enclosing additional questions for response for the record of the Small Business Committee's hearing on the Fiscal Year 1983 Budget for the Small Business Administration. Please excuse the delay in our response.

Question 1: Once Congress has enacted authorizations for commitments to guarantee and, where necessary has provided appropriations for programs under the jurisdiction of the Small Business Administration (SBA), will the SBA adhere to those Congressional decisions or the unilaterial decisions by the Office of Management and Budget (OMB) to restrict commitments below the Congressionally determined levels?

The Small Business Administration endeavors to follow guidance provided by our governing statutes in determining program levels, authorized and appropriated. In the case of the pollution control bond program SBA has been authorized to guaranty up to $250 million in contracts for Fiscal Years 1982 and 1983. However, the Executive Branch has available to it certain procedures governing deferrals, reprogrammings, and recision of funds appropriated by the Congress. Under those procedures SBA has taken the following actions with respect to the pollution control bond program:

	($ in millions) FY 1982	FY 1983
FY 1982 Budget Request (Carter Request)	$ 125	$ -
FY 1982 Revised Budget Request (Reagan March Revision)	95	-
FY 1982 Authorization (P.L. 97-35, 8/13/81)	250	250
FY 1983 Budget Request (Agency FY 1982 Revised Request)	250	250
OMB Credit Control Memo (Nov. 5, 1981)	50	-

	($ in millions) FY 1982	FY 1983
FY 1983 Congressional Submission (Revised Through Internal Negotiations Dec. 1981)	150*	150*
FY 1982 Congressional Response:	250	-

*Note - This amount resulted from a reduction in General Business Guarantees of $100 million plus a provision not to grant tax exempt financing after December 31, 1981. The $250 million level has been submitted to OMB for reapportionment and we are awaiting their response.

Enclosed is the material requested in your second question.

Sincerely,

James C. Sanders

James C. Sanders
Administrator

Enclosure

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

MAR 2 1982

Honorable Lowell P. Weicker, Jr.
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In accordance with requirements contained in the Committee's report, I have notified the Appropriations Committee of the following proposed changes:

Small Business Development Center (SBDC)

Public Law 97-92 reflects $14 million for grants for SBDC as authorized by section 20(a) of the Small Business Act. The FY 1982 current estimate (FY 1983 Congressional Submission) provides $8.5 million for SBDC grants and $10.5 million for the SBDC Program. The proposed amending language has been submitted in the Administration's FY 1983 budget request.

It is currently estimated that the $8.5 million for SBDC grants will be sufficient to fund current commitments. In addition, $2 million will be available for other SBDC requirements. The following chart will reflect the current estimate for FY 1982:

Original Amount Available		$14,000,000
SBDC Grants	$8,500,000	
SBDC Evaluation Study	900,000	
SBDC Computerized Reporting	75,000	
SBDC Advisory Council	250,000	
SBDC Clearing House Functions	350,000	10,075,000
Amount Available to Absorb Pay Raise		3,925,000

Inspector General (IG)

The increase of $300,000 for 10 additional positions has been utilized to absorb the increased pay cost and other related salary costs.

It was determined that the current on-board employment (130 full-time permanent employees) was adequate to perform all IG responsibilities.

Business Loan and Investment Fund

Public Law 97-92 reflects new budget authority of $326 million in support of a $3.525 billion Financial Assistance program. The FY 1982 current estimate also reflects $326 million of new budget authority, but in support of a reduced program level of $2.96 billion. This reduction is all in guaranteed lending and is detailed within a deferral action submitted as part of this year's budget request. In addition, $6 million in direct funds was reprogrammed from Economic Opportunity to Minority Enterprise Small Business Investment Company (MESBIC) Assistance, in order to foster greater private sector participation and take advantage of the leveraging effects of the MESBIC Program.

Surety Bond Guarantees Revolving Fund

Public Law 97-92 and the current estimate reflect $19 million for new budget authority. However, a deferral action has been submitted reducing the program level from $1.2 billion to $1.08 billion.

Pollution Equipment Contract Revolving Fund

The reduction in program level from $250 million to $150 million has previously been discussed in our letter to your Committee dated January 29, 1982.

The above summarizes significant changes within the FY 1982 current estimates. We will be pleased to furnish any additional information that the Committee may require.

Sincerely,

Donald R. Templeman
Acting Administrator

[redacted]

United States Senate

COMMITTEE ON APPROPRIATIONS
WASHINGTON, D.C. 20510

February 26, 1982

Honorable Donald R. Templeman
Acting Administrator
Small Business Administration
1441 L Street, N.W.
Washington, D.C. 20416

Dear Mr. Templeman:

This is in response to your letter requesting that the Small Business Administration Pollution Control Equipment Contract Guarantee program be reduced from a funding level of $250 million to a funding level of $150 million, and that no funds be authorized for tax exempt bonds.

Your request is contrary to the legislative history of P.L. 97-35 and H.J. Res. 370 and is hereby denied.

Under P.L. 97-35, the guarantee level for this program was set at $250 million in anticipation that the SBA would enter into the full amount of commitments authorized. The reason this was done was because of a demonstrated need by small businesses for this level of commitment and a recognition that this program has been one of SBA's most successful and problem-free programs.

Since its inception, SBA has guaranteed over $250 million in principal amount of obligations, for over 200 small companies, employing nearly 20,000 people. Financing for pollution abatement facilities has occurred in 25 states with more participating states projected in the future. Since this program was enacted in 1976, a revolving fund capitalized at $15 million has grown to over $37 million because of fees charged borrowers for processing and guaranteeing the bonds, with minimal losses to the government. It is, thus, one of a very few Federal programs that actually return funds to the government.

We trust you will take appropriate steps to comply with Congressional intent.

With best regards.

Ernest F. Hollings, Ranking
Minority Member
State, Justice, Commerce, the
Judiciary and Related Agencies
Subcommittee

Lowell Weicker, Jr., Chairman
State, Justice, Commerce, the
Judiciary and Related Agencies
Subcommittee

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

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OFFICE OF THE ADMINISTRATOR

Honorable Donald A. Templeman
Acting Administrator
Small Business Administration
Washington, D.C. 20416

Dear Mr. Templeman:

The transmittal of the 1983 Budget marks another significant step in the President's economic program. I want to thank you for your cooperation in its preparation.

The enclosures to this letter provide ceilings for your agency in addition to those included in the 1983 Budget. The multi-year planning ceilings for budget authority and related outlays for 1984-1987 are included in Enclosure A. These are the amounts within which your agency's program should be planned. No increases should be contemplated unless they are required because of circumstances beyond the agency's control.

Ceilings on civilian employment for your agency are provided in Enclosure B.

Significant Policy Determinations

Minority Business Development. Consistent with the decision of the Budget Review Board to "reopen the issue of consolidating procurement-related programs of the SBA and the Department of Commerce," SBA is to provide by March 9, 1982, an analysis of the advantages and disadvantages of the proposed consolidation. The analysis should cover the possible options of consolidating minority business assistance programs in the Department of Commerce and in SBA, as well as the option of maintaining autonomous programs in the two agencies. It should also provide an assessment of the relative costs of each option, including dollars and personnel.

In addition, SBA will develop and provide to this office, for concurrence, a set of performance indicators and types of data that can be used to evaluate the effect of its programs on the minority business community. Particular emphasis should be given to developing measures and a data base that can be used to assess the impact of SBA programs in developing minority firms that can compete in the private sector without Federal assistance. These performance measures are to be submitted to OMB by April 15, 1982.

Direct Loans. The 1983 budget proposes to eliminate all direct loans in 1983 and beyond. However, $41 million is requested for SBA purchase of MESBIC debentures and preferred stock, with the caveat that no more than $16 million can be used for preferred stock purchases.

Guaranteed Loans. The 1983 budget proposes a continued reduction in SBA guaranteed loans. It assumes that SBA will achieve the reduced credit levels by:

-- reducing the Government's risk (i.e., level of guarantee) for loans to businesses that are not owned by socially and economically disadvantaged individuals.

-- targeting assistance to achieve well-defined, socio-economic objectives (e.g., providing 17% of guaranteed loans to minority-owned businesses and directing other loans to first-time borrowers to erode market perceptions that they are high risks).

-- developing criteria to restrict the purposes for which loans can be used.

A specific plan and proposed policies for achieving the reduced credit levels and for targeting the available assistance should be provided to OMB by April 15, 1982.

Debt Collection. The outlays estimated in the budget reflect increased revenues of $100 million in 1982 and $175 million in both 1983 and 1984 from agency debt collection efforts. It is anticipated that SBA will begin to contract out loan collection and servicing activities no later than the start of fiscal year 1983. Therefore, SBA should develop and submit to this Office by March 15, 1982, its plans for contracting-out such activities.

Our energies must now be directed toward obtaining Congressional support for the objectives set forth in the budget. This will take a considerable effort on all our parts and will require diligent support of the President's policies in our communications with both the Congress and the public.

Once again, and on behalf of my staff, your cooperation in preparing the 1983 Budget is much appreciated.

Sincerely,

David A. Stockman

Enclosures

Enclosure A

Multi-Year Planning Estimates
($ in millions)

	1984	1985	1986	1987
Budget authority	382	346	333	290
Outlays	68	31	32	26

Details concerning the derivation of these totals can be provided by staff of this Office.

Enclosure B

	Full-time Equivalent		
	1982 ceiling	1983 ceiling	1984 ceiling
Employment Ceilings			
Total employment, excluding disadvantaged youth and personnel participating in the Worker-Trainee Opportunity Program (WTOP)..	4,516	4,223	4,108
Full-time permanent employment, excluding personnel participating in WTOP.....	4,145	3,923	3,808

These ceilings represent the upper limits for FY 1982, FY 1983, and FY 1984, on the number of full-time equivalents (workyears) for your agency.

These ceilings cover all employment in your agency except for disadvantaged youth and personnel participating in the Worker-Trainee Opportunity Program.

NEAL SMITH
MEMBER OF CONGRESS
FOURTH DISTRICT, IOWA

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Congress of the United States
House of Representatives
Washington, D.C. 20515

February 11, 1982

CHAIRMAN
APPROPRIATIONS SUBCOMMITTEE FOR:
DEPARTMENT OF COMMERCE
DEPARTMENT OF JUSTICE
DEPARTMENT OF STATE
FEDERAL JUDICIARY
SMALL BUSINESS ADMINISTRATION
FEDERAL TRADE COMMISSION
F.B.I.
S.E.C.
F.C.C.
INTERNATIONAL TRADE COMMISSION
U.S. TRADE REPRESENTATIVE
U.S. ARMS CONTROL AGENCY
UNITED NATIONS AGENCIES
MEMBER
APPROPRIATIONS SUBCOMMITTEE FOR:
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DEPARTMENT OF LABOR
DEPARTMENT OF TRANSPORTATION
N.L.R.B.
R.R. RETIREMENT BOARD
NATIONAL INSTITUTES OF HEALTH
SOCIAL SECURITY
PUBLIC HEALTH SERVICE
MISCELLANEOUS RELATED AGENCIES
MEMBER
COMMITTEE ON SMALL BUSINESS

Mr. Donald Templeman
Acting Administrator
Small Business Administration
Washington, D. C. 20416

Dear Mr. Templeman:

This refers to the letter of January 29 from Mr. Cardenas indicating that the Small Business Administration has decided to reduce the Pollution Control Equipment Guarantees program to a level of $150 million for FY 1982 and to eliminate funds for tax exempt bonds after December 31, 1981.

The Committee hereby disapproves this proposal and strongly urges you to make available the full authorization of $250,000,000 for the Pollution Control Equipment Guarantees program, as contained in Public Law 97-35, the Omnibus Budget Reconciliation Act of 1981. Demand for this guarantee program continues to be very strong. Your proposed action could have an extremely detrimental effect on the ability of many small businesses to obtain the necessary funds to comply with state and local pollution control requirements. In addition, as Mr. Cardenas noted in his letter, this program has not sustained any losses since its inception and has thus made money for the Federal Government through the fees charged. Therefore, we believe that this program has been proven to be an efficient means of meeting the needs of the small business community while at the same time protecting the interests of the taxpayer. We expect you to make available the full level authorized for the program for FY 1982 by the Congress.

With best wishes.

Sincerely,

Neal Smith

Neal Smith, Chairman
Subcommittee on Commerce,
Justice, and State, the
Judiciary and Related
Agencies

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U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

January 29, 1982

Honorable Lowell P. Weicker, Jr.
Chairman
Subcommittee on the Departments
of Commerce, Justice, State,
the Judiciary, and Related Agencies
Committee on Appropriations
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Pollution Control Equipment Contract Guarantees program level for FY 1982 has been reviewed with respect to its consistency with the Administration's credit control policies. Within the context of the Economic Recovery Program and its efforts to reduce the amount of Federal credit involvement in the marketplace, we feel that this program should be reduced to a level of $150 million and that no funds be authorized for tax-exempt bonds after December 31, 1981, rather than the $250 million contained in the Committee's report.

As a group, small businesses will benefit more from the Administration's efforts to stabilize financial markets, reduce interest rates, eliminate regulations and lower inflation than the very small percentage of clients assisted through this program. In addition, the revised program level of $150 million represents a 50 percent increase over FY 1981 actual program level of $100 million. An increase of a greater magnitude could create deficiencies in the delivery of a program that has not sustained any losses since its inception.

Therefore, in accordance with requirements contained in the Committee's report, I am notifying you of this action. Also, proposed credit limitation language for FY 1982 reflecting this level will be transmitted with the President's FY 1983 Budget Request.

Sincerely

(Signed) Michael Cardenas

Michael Cardenas
Administrator

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

November 25, 1981

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Stockman:

We have reviewed the initial allowances made by the Office of Management and Budget for the Small Business Administration's Fiscal Year 1983 Budget Request. We certainly concur in the President's efforts to restore a sound economy to the Country through the establishment of controls on Federal spending. This was reflected in our Budget Submission which represented a 50 percent reduction in outlays and a 31 percent reduction in budget authority from the 1982 levels as revised in September.

Over the past year, and as reflected in the allowance for Fiscal Year 1983, the Office of Management and Budget has placed considerable emphasis on debt collection efforts and elimination of waste, fraud and abuse, not only at SBA but across the government.

SBA's management has pursued a similar track over the last seven months by instituting tighter controls on collection efforts in both the disaster and regular business lending portfolios and by implementing new regulations governing the operation of our minority enterprise assistance programs. We concur that these controls have not received proper attention in the past and that adequate resources must be allocated to these functions.

However, what is missing in OMB's approach, as included in the allowance for Fiscal Year 1983, is attention to this Agency's statutory mission to "aid, counsel and assist..." small businesses. We cannot continue to perform this mission within the budgetary constraints proposed by OMB. While we agree that direct lending by this Agency should be curtailed, our future service to small business must include a strengthening of our non-lending functions. This can be accomplished within the Agency's original

budget request, even with selective reductions, by emphasizing utilization of private sector delivery mechanisms. It cannot be accomplished with continued across the board, large scale reductions as OMB has proposed.

Therefore, we feel that there are several areas contained in the initial allowance that are inconsistent with the statutory mission of the Agency and the realities of the political awareness and needs of the small business community. These items are summarized in the following enclosures in the order of Agency priority.

My staff and I would be pleased to meet with you to discuss these positions further.

Sincerely,

Michael Cardenas
Administrator

Enclosures

Small Business Administration

Transfer of the Minority Assistance Program [8(a)]

The Small Business Administration (SBA) received its pass back on November 20, 1981. Among OMB's determinations is a decision to assign the SBA's minority assistance program to the Department of Commerce. This decision is contrary to pertinent facts regarding program administration and clear desires to limit program costs. While we concur that a merger of Federal Minority Business Enterprise programs is desirable, we also feel that a restatement of the realities of the merger to the Department of Commerce must be made.

A number of key elements of the 8(a) program's administration, support retention of the program by SBA. The SBA minority assistance program is legislated under Public Laws 95-507 and 96-481. On November 23, 1981, new program rules and regulations designed to insure adequate control, and broaden assistance within current budgetary constraints, were finalized in the Federal Register in accordance with Public Law 96-481. The SBA is the only Federal agency that has subcontracting authority, which is the key delivery mechanism of the program. The SBA has legislated programs in management, procurement and financial assistance and surety bond guarantees which complement and are administered jointly with the 8(a) program. These program operations are performed in seventy-four field offices throughout the nation.

In addition the SBA has legislated authority in small and small disadvantaged business goal setting and size standards, review and appeal. Transfer of these functions will destroy the current balance between small business and minority business enterprises in setting procurement goals. Removal of size standard requirements from the 8(a) program will result in larger established businesses, which do not need the advantages of the program, receiving its benefits to the detriment of smaller, less competitive enterprises.

It should be noted that support is provided to the 8(a) program which involves personnel not in the 8(a) program. These professionals include loan officers, procurement center representatives, subcontract specialists, District Counsels, and management assistance officers. It is difficult to envision a merger of the 8(a) program in the Department of Commerce without accounting for these and many other administrative and legislative nuances.

If the 8(a) program is to continue to operate, the Department of Commerce would have to duplicate the current SBA programs and the delivery network.

Currently MBDA's program authority is contained in Executive Orders 11458 and 11625, not in statute. Abolishing the MBDA

program could easily be accomplished through recision of these existing Orders. Legislative action would be required to remove authority from SBA and create a new program at the Department of Commerce. Congressional approval of such legislation is doubtful at best.

From a practical standpoint, the easiest and most effective action is to merge the Department of Commerce minority assistance program into the SBA. Under current authorities contained in the Small Business Act, SBA would provide management assistance now being provided by DOC and administer the Minority Purchasing Council Program. It is estimated that SBA could perform their functions for an additional $10 million. This would provide a central, non duplicative program at a far greater cost savings for the taxpayers.

The SBA is ready and willing to support any final decision made by the Administration but believes that the SBA has the experience and know how to best manage and direct the merged program. It is also our conviction that merger of minority enterprise assistance programs to SBA best reflects the intent of the President's program to more efficiently administer Federal government programs.

To assist in understanding the options of the merger and we have attached a graphic presentation of the various opinions. (Attachment I)

Undesignated $20 Million Reduction

This reduction accompanied by previously dictated decreases would impose a severe hardship upon this Agency to provide even the most minimal assistance to the small business community. Ignoring the proposed transfer of functions, this would result in a reduction of almost 1000 employees from the present level of the Agency in less than a two year period. This would reduce the staffing of the Agency to a level last attained in 1963 when there were some 6700 loans valued at $350 million made and a portfolio of less than $900 million. Ignoring for the moment the multitude of additional programs that have been statutorily added over the years, we will make some 20,000 loans for $2.5 billion in FY 1983 and be servicing a portfolio in excess of $19.0 billion.

With reduction in our existing program areas already mandated, the practical alternative that remains is to absorb the 500 positions, associated with the $20 million reduction, through our support activities. As a result of this action, the Agency will sustain a crippling blow to its "debt collection effort". It is anticipated that approximately 1600 positions will be available for support activities by the end of FY 1982. Of this total, over 700 positions are either directly or indirectly related to the oversight, litigation, collection, account maintenance, and general support of the Agency's portfolio.

Management Assistance

The effect of reducing the Management Assistance personnel force by 100 in Fiscal Year 1983 in addition to substantial reductions in recent years would seriously impact the performances of other required missions including leveraging of resources. Acknowledging that Management Assistance people will no longer be involved in direct outreach programs, this major reduction in personnel will also reduce the total effect of the outreach of the leverage resources also. Those not close to the operations of SBA should be reminded that Management Assistance is by far the largest interface that the Federal Government has with small business. Last year, Management Assistance had almost 500,000 client relationships. Notwithstanding the difficulty of measuring the impact of Management Assistance from a quality point of view, the fact remains that this program was not a source of major embarrassment that some of the other programs at SBA have been.

Considering that Management Assistance may be one of the few legitimate and effective areas for the Reagan Administration to serve the small business community, a careful analysis should be made before reducing the potential of this outreach. This further reduction also ignores the efforts of Management Assistance in providing assistance to portfolio clients. These efforts are certainly an integral part of the accelerated debt collection efforts.

The limitation imposed on the number of states for SBDC's participating in the program flies in the face of recent events. There have been continuing efforts made to curtail or eliminate this program. To each attempt Congress has reacted in a negative fashion. This attitude is reflected in the $17.0 million level presently contained in the House Bill, and the $14.0 million level in the proposed Conference Report. There presently are five states with proposals pending in house or anticipated in the near future. The proposed policy continues this conflict between OMB and Congress. The same arguments are also applicable to the proposed FY 1983 funding level.

With respect to the recommendations on SBDC's, a management judgment here is almost immaterial. In other words, this program is a creature of the Congress. Its future largely depends on the trade-offs that the key Congressional people are willing to make with OMB in other areas. Our responsibility at SBA is simply to administer whatever results from the negotiation.

International Trade

It has been estimated that every additional $1 billion of exports results in a total GNP increase of $2 billion. Each $1 billion of exports produces 40,000 new jobs. There are

approximately 20,000 small businesses capable of immediate export, given proper encouragement and recognition of potential. Small business represents approximately 40 percent of the GNP yet produces only some 16 percent of the export sales. When small business accounts for some 86 percent of all new employment in the private sector, it becomes immediately obvious that increased participation in exporting by small business translates directly to employment.

Obviously, Administration policy as stated in the "Administration Statement on U.S. Trade" is directed toward the expansion of international trade. Public Law 96-481 specifically mandates SBA's establishment of an Office of International Trade, and outlines responsibilities and duties that office is to perform.

To suggest the elimination of International Trade from the SBA budget is to target a specific small business segment for reduction of governmental assistance. The SBA mandate is to "aid, counsel, and assist..." small business, not just the segment dealing in retailing or wholesaling or restauranteuring, but all aspects of the economy, of which international trade is one.

We concur that much assistance to small exporters can be provided through the private sector. With the very limited resources requested, SBA would be able to insure that small businesses know where such assistance and expertise is available. In addition, SBA's International Trade personnel will serve to encourage non-government groups to provide necessary assistance to small exporters.

SBA's International Trade activities will not "subsidize only a minute percentage of the small business businesses" as indicated in the passback. No subsidy will be provided at all, but more importantly, a large number of businesses will be provided with information and assistance which will ease the difficult tasks involved in marketing products internationally. The program projected by SBA is targeted toward encouraging and directing small business into exporting through the expertise available in the private sector. The importance of encouraging even a small percentage of small businesses into exporting can be most impressive. If SBA is able to encourage only 5,000 small businesses into exporting and annual sales average $200,000, our limited budget would produce 40,000 new jobs and $1 billion to offset our trade deficit.

Pollution Control

Consistent with our response to the FY 1982 Federal Loan Guarantees determinations as contained in the President's memorandum of November 5, 1981, we are proposing that the program level be increased to $150 million predicated on the

elimination of the tax exempt feature. In addition, there would be a corresponding decrease in our General Business Loan Guarantees in order to remain within our total guarantee level.

Disaster Loan Making

There is serious concern that the $7.2 million provided for Disaster Loan Making is insufficient to support the FY 1983 planned program level of $440 million. The $7.2 million provided for salaries and related expenses will support only 275 man years. However, based on actual fiscal year 1981 results, it will require at least 450 man years or $12 million in salaries and expenses to support a Disaster program level of $440 million. In view of the fact that these monies are transferred from the Disaster Loan Fund, which is currently self-sufficient, language should be included to provide flexibility sufficient to accommodate an extraordinary demand for salaries and expenses so as to preclude supplemental appropriation action.

	DECISION	ACTION REQUIRED	COST ELEMENTS
OMB Position	Merge SBA 8(a) program into DOC	- Enactment of new legislation	As proposed: $40 millio
		- Repeal of existing staturoty authority	Commerce Appeal + $20 millio
		- Creation of extensive field delivery network	(Undetermined additiona costs not anticipated by OMB)
		- Promulgation of new program rules & regulations	
		- Creation of support stafffor contract identification and legal review	Estimated Cost: (at least) $60 millio
SBA Position	Merge DOC Minority Business Enterprise Programs into SBA	- Repeal of two existing Executive Orders	Original MSB request: $21 millio
		- Expansion of current SBA 7(j) program to encompass Business Development grants	Increased 7(j) Dollars: $10 millio
		- Expansion of current SBA private sector initiatives to encompass Minority Purchasing Council Program	Retain funding for BDE: $10 millio Estimated Cost: $41 milli
White House Office of Policy Development Position	Create a new entity to provide assistance to minority businesses	- Creation of totally new programs	
		- Enactment of new legislation creating new program	
		- Repeal of existing statute	
		- Significantly increased budget to provide greater level of assistance to minority business enterprises	
		- Increased personnel	
		- Selection or creation of agency to administer	
		- Re-creation of Directing Lending Program	Estimated Cost: $ 293 milli
		- Creation of a Duplicative Equity Financing Program	

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

OCT 22 1981

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Stockman:

I am pleased to transmit to you the Revised Budget Submission for the Small Business Administration for FY 1983. The revised request reflects the Administration's 12 percent reductions in the Budget Authority Request for FY 1982 along with a 50 percent reduction in the current policy level outlays in FY 1983.

Although in total support of the President's economic objective, it is incumbent upon me to point out that the significant outlay reductions mandated in FY 1983 will cause the total elimination of the Direct Loan Program with the exception of a limited amount for the Minority Enterprise Small Business Investment Company Program. This would create a situation where there would be no alternative source of financing, at any cost, to small businesses that cannot qualify for financial assistance from the private sector. Therefore, if the Administration has any flexibility in its overall budget request to Congress, this issue should be addressed.

The FY 1983 Budget Request is based on the approved redistribution of the 12 percent across-the-board reduction. This will minimize the adverse impact of a major employment reduction in FY 1982 which would undoubtedly result in placing the Agency in a reduction in force posture. However, any additional personnel reductions will have a serious impact on the Agency's overall effort to step up debt collection activities so as to obtain the targeted $175 million increase in FY 1983 loan receipts.

Therefore, in summary, our revised FY 1983 Budget Submission reflects a total request for budget authority of $382 million and $260 million in outlays. This reflects a substantial decrease from our original FY 1983 request of $665 million for budget authority and $520 million in outlays, and is consistent with the Administration's allowance. In addition, we have enclosed our proposed Personnel Reduction Plan.

This provides a brief summary of our Revised Budget Submission for FY 1983. We would be very pleased to discuss our views concerning this revised submission at your earliest convenience.

Sincerely,

Michael Cardenas
Administrator

Enclosures

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

SEP 29 1981

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Stockman:

I am pleased to transmit to you the budget request for the Small Business Administration for FY 1983. This request has been developed under three alternative funding levels (reduced, current, and requested) in accordance with instructions contained in Office of Management Budget Circular No. A-11. I believe this request is consistent with overall national priorities and includes major emphasis in three functional areas:

Portfolio Management - Substantial increases in personnel will be required to service an already deteriorating loan portfolio valued at over $17 billion. In the past nine years, the portfolio has quadrupled with no increase in personnel. Without additional resources, the portfolio will continue to reflect loss of Government equity.

Inspector General - The Administration has placed considerable emphasis on waste, fraud, and abuse. Due to the great number and variety of programs within the SBA, it is essential that additional resources be placed within this activity.

Data Management - Additional resources in Data Management will minimize future personnel requirements throughout the various activities of the Agency. Enhanced Automatic Data Processing efforts and continuation of our Small Business Data Communication Network will provide the information necessary for making effective management decisions.

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At the requested levels, Budget Authority reflects an increase of $69 million from $636 million in FY 1982 to $705 million. The outlays reflect a reduction of $103 million from $785 million in FY 1982 to $682 million for 1983.

This provides a brief summary of our budget request for FY 1983. We are looking forward to further discussions concerning this request with members of your staff.

Sincerely,

Michael Cardenas
Administrator

Enclosure

SMALL BUSINESS ADMINISTRATION

FY 1983 BUDGET - OMB SUBMISSION

BUDGET OVERVIEW

INTRODUCTION

The Small Business Administration's mission is to increase the market share, representativeness, and the continuing existence and growth of small business in our national economy in order to preserve free competitive enterprise.

> "only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assurred." 1/

This overall mission is paramount throughout the planning process and across all programs and activities. SBA plans to pursue this mission through the optimum utilization of the private sector in combination with Federal Government resources. However, our request does reflect the Administration's effort to reduce overall Federal spending. Reductions in the Business and Disaster Lending Programs are consistent with PL 97-35 and the Administration's efforts to control the expansion of Federal Credit programs and to reduce dependence on the Federal Government as a supplier of credit.

In addition to these programmatic strategies, this budget submission also emphasizes the improvement of SBA's internal management and controls which are necessary both to safeguard the interests of the taxpayer, as well as ensure the efficient and effective delivery of services to our clientele.

This request has placed major emphasis on three areas of serious concern and even with available resources currently being directed in these areas, it is our considered judgement that this will not resolve these problems. Therefore, we strongly recommend that additional resources be provided in the following areas:

> PORTFOLIO MANAGEMENT - Presently the Agency has a deteriorating loan portfolio valued at over $17 billion of which over $9 billion are SBA serviced loans. This portfolio has quadrupled in the last nine years with no increase in personnel. During this period, the Agency has been involved in Disaster Farm Lending which added over 78,000 loans valued at almost $3 billion which has presented not only a disruption to our normal activities but has also created some unique servicing problems. Therefore, we are requesting an increase of 278 permanent positions. In view of the fact that there has been no final determination as to the ultimate disposition of this portfolio, we are also requesting 220 temporary positions to service the Disaster Farm portfolio.

1/ Section 2, Small Business Act.

DATA MANAGEMENT - In order to minimize the requirements for excessive personnel resources throughout the various Agency's activities, it is recognized that an upgrading of our present Data Management facility, including eighteen additional positions is necessary, especially in regard to their responsibility for the timely updating of loan portfolio accounts. It is a foregone conclusion that the proper utlization of a Data Management facility ultimately reduces an organizations manpower requirements. This is evidenced by this Agency's ability in absorbing a variety of additional mandated programs without corresponding increases in personnel resources.

INSPECTOR GENERAL - In view of the emphasis placed on waste, fraud, and abuse by this Administration, and because of the variety of programs and delivery mechanism utilized by this Agency, it is imperative that additional personnel resources be made available for this purpose. Therefore, this submission requests 31 additional Inspector General (IG) positions to effectively deal with the mounting problems of waste, fraud, and abuse. The effective utilization of IG personnel has historically more than offset their salary and related expense costs.

In summary, the management capabilities of SBA must be strengthened and information must be available, accessible and up-to-date to handle the constantly changing programs and the new initiatives that the SBA is pursuing, especially in the area of Portfolio Management.

Request

All of the major programs have been ranked according to the priorities discussed in the SBA budget overview. The incremental effect of the reduced current and requested levels of the major programs on required positions, outlays and budget authority are displayed on the ranking.

The SBA request for FY 1983 is for $705 million in budget authority and $682 million in outlays of which $260 million in Budget Authority is required for salaries and expenses. In addition, this submission is requesting 4,885 permanent positions.

SMALL BUSINESS ADMINISTRATION

FY 1983 OMB SUBMISSION

Comparison of Budget Authority and Outlays
($ in Millions)

	FY 1982		FY 1983		
BUDGET AUTHORITY	Budget Request	Revised	Reduced Level	Current Level	Requested Level
Relatively Uncontrollable Programs:					
DLF	--	--	--	--	--
Discretionary Programs:					
S&E	211	223	217	233	260
BLIF	387	362	348	408	419
SB	22	22	17	20	20
PC	--	--	--	--	--
LG	4	4	4	4	6
Subtotal	624	611	586	665	705
TOTAL	624	611	586	665	705
OUTLAYS					
Relatively Uncontrollable Programs:					
DLF	-91	9	-201	-201	-70
Discretionary Programs:					
S&E	222	242	236	252	282
BLIF	525	512	421	471	472
Sb	31	25	18	21	21
PC	-7	-7	-21	-26	-26
LG	4	4	3	3	3
Subtotal	775	776	657	721	752
TOTAL	684	785	456	520	682

SMALL BUSINESS ADMINISTRATION

FY 1983 OMB SUBMISSION

Program Levels
($ in millions)

AGENCY PROGRAMS	FY 1981 Estimate	FY 1982 Reagan	FY 1982 Revised	FY 1983 Reduced	FY 1983 Current	FY 1983 Requested
Financial Assistance						
Business Loans	$3,219	$2,940	$2,933	$2,525	$2,833	$2,833
Direct	219	165	125	95	125	125
Guaranteed	3,000	2,775	2,808	2,430	2,708	2,708
Equal Oppor. Loans	87	95	105	80	105	105
Direct	65	45	45	30	45	45
Guaranteed	22	50	60	50	60	60
Handicapped Asst. Loans	26	20	20	20	20	20
Direct	25	15	15	15	15	15
Guaranteed	1	5	5	5	5	5
Energy Loans	20	25	27	25	27	27
Direct	10	-	10	10	10	10
Guaranteed	10	25	17	15	17	17
Dev. Company Loans	76	150	250	200	350	350
Direct	6	-	-	-	-	-
Guaranteed	70	150	250	200	350	350
Total Financial Assistance	3,428	3,230	3,335	2,850	3,335	3,335
Direct	325	225	195	150	195	195
Guaranteed	3,103	3,005	3,140	2,700	3,140	3,140
Investment Assistance	132	180	195	162	195	290
MESBIC	42	35	35	27	35	35
SBIC	90	145	160	135	160	255
Disaster Assistance	1,650	440	440	440	440	600
Physical	1,600	440	440	440	440	600
Non Physical	50	-	-	-	-	-

PROGRAM LEVEL
($ in millions)

	FY 1981 Estimate	FY 1982 Reagan	FY 1982 Revised	FY 1983 Reduced	FY 1983 Current	FY 1983 Requested
Surety Bond	1,500	1,200	1,400	1,200	1,400	1,400
Pollution Control	100	95	250	200	250	250
Business Development Expense	20	20	24	20	24	24
SBDC	8.5	-	8.5	6	8.5	12
SBI	1.5	1.5	1.5	1	1.5	2
Call Contracts	-	2	2	1	2	2
SCORE	1.9	2.1	2.1	1.9	2.1	2.1
7(J) Contracts	10	10	10	8	10	10
Advocacy Research	2.9	2.9	2.9	3	3.6	3.6
Disaster Loan Making	26.5	10.7	19.2	19.2	19.2	22.1

SMALL BUSINESS ADMINISTRATION
FY 1983 OMB SUBMISSION
SALARIES AND EXPENSES
($ 000's)

Decision Unit	FY 1981 Estimate	FY 1982 Estimate	FY 1983 Reduced Level	FY 1983 Current Level	FY 1983 Requested Level	Reduced to Current	Current to Requested
Procurement Assistance	11,172	9,964	9,869	10,267	12,039	398	1,772
Program Direction	1,382	1,363	1,331	1,399	1,420	68	21
PASS	1,244	1,240	1,178	1,249	1,568	71	319
COC	1,467	1,450	1,451	1,522	1,643	71	121
Prime Contracts	2,532	2,618	2,629	2,701	2,850	72	149
Sub Contracts	1,901	1,895	1,890	1,938	2,014	48	76
Technology Assistance	2,079	1,019	1,048	1,078	1,943	30	865
Property Sales	567	379	342	380	601	38	221
Management Assistance	28,684	30,653	25,157	30,384	35,109	5,227	4,725
Program Direction	4,284	4,005	3,883	4,097	4,216	214	119
Counseling	6,398	6,003	5,965	6,297	6,366	332	69
Small Business Inst.	1,500	1,500	1,000	1,500	2,000	500	500
SCORE/ACE	1,650	1,650	1,500	1,650	1,650	150	-
Call Contract	-	2,000	1,000	2,000	2,000	1,000	-
Training	2,282	2,260	2,261	2,398	2,499	137	101
Small Bus. Dev. Centers	1,390	2,165	1,168	1,293	1,308	125	15
SBDC Contracts	8,500	8,500	6,000	8,500	12,000	2,500	3,500
Program Support	1,802	1,739	1,640	1,794	2,054	154	260
International Trade	878	831	740	855	1,016	115	161
Financial Assistance	74,729	69,118	71,308	72,662	81,941	1,354	9,279
Program Direction	5,102	5,085	5,207	5,604	5,805	397	201
Guaranty Lending	11,623	11,485	11,799	12,259	12,369	460	110
Direct Lending	4,344	2,631	2,645	2,806	2,853	161	47
Disaster Assistance	225	238	243	254	269	11	15
Disaster Loan Making	24,007	19,200	19,200	19,200	22,100	-	2,900
Portfolio Management	27,014	27,985	29,709	29,878	35,859	169	5,981
Lender Relations & Cert.	2,414	2,494	2,505	2,661	2,686	156	25
Investment Assistance	3,396	3,088	3,075	3,205	3,228	130	23
Investment	1,460	1,330	1,314	1,402	1,416	88	14
Special Guarantees	1,936	1,758	1,761	1,803	1,812	42	9

SMALL BUSINESS ADMINISTRATION
FY 1983 OMB SUBMISSION
SALARIES AND EXPENSES
($ 000's)

Decision Unit	FY 1981 Estimate	FY 1982 Estimate	FY 1983 Reduced Level	FY 1983 Current Level	FY 1983 Requested Level	Reduced to Current	Current to Requested
Minority Small Bus. - COD	22,402	22,197	20,055	22,314	22,425	2,259	111
Prog. Dir. & Other MSB	3,117	3,192	3,156	3,233	3,274	77	41
Bus. Dev. - 8(a)	7,575	7,349	7,265	7,418	7,474	153	56
Bus. Asst. - 7(j)	1,710	1,656	1,634	1,663	1,677	29	14
Call Contracts	10,000	10,000	8,000	10,000	10,000	2,000	-
General Counsel	11,177	11,965	11,889	12,113	12,230	224	117
Policy, Plan. & Budgeting	6,010	6,840	6,290	7,015	7,217	725	202
Advocacy	7,342	7,092	6,943	8,180	8,833	1,237	653
Advocacy	2,400	2,294	1,906	2,335	2,738	429	403
Economic Research	428	456	638	732	757	94	25
Research Contracts	2,850	2,850	3,000	3,600	3,600	600	-
Women's Bus. Enterprise	1,664	1,492	1,399	1,513	1,738	114	225
Cong. & Legis. Affairs	551	565	562	586	586	24	-
Public Communications	1,083	967	987	1,133	1,236	146	103
Personnel Management	2,498	2,679	2,383	2,727	3,457	344	730
Field Services	1,537	1,842	1,732	1,853	1,910	121	57
Data & Mgmt. Services	33,357	42,746	43,353	45,701	56,721	2,348	11,020
Data Management	8,307	11,946	10,546	12,035	16,497	1,489	4,462
Management Services	25,050	30,800	32,807	33,666	40,224	859	6,558
Equal Employ. Opport. & Compliance	1,759	1,899	1,961	2,044	2,044	83	-
Inspector General	4,894	5,608	5,484	5,935	6,875	451	940
Exec. Dir. & Field Admin.	24,661	25,077	25,098	26,252	26,468	1,154	216
Total	235,252	242,300	236,146	252,371	282,319	16,225	29,948

SMALL BUSINESS ADMINISTRATION
FY 1983 OMB SUBMISSION
PERSONNEL

Decision Unit	FY 1981 Estimate	FY 1982 Estimate	FY 1983 Reduced Level	FY 1983 Current Level	FY 1983 Requested Level	Reduced to Current	Current to Requested
Procurement Assistance	213	213	196	213	213	17	-
Program Direction	31	31	29	31	31	2	-
PASS	9	9	9	9	9	-	-
COC	37	37	31	37	37	6	-
Prime Contracts	63	63	60	63	63	3	-
Sub Contracts	46	46	45	46	46	1	-
Technology Assistance	18	18	16	18	18	2	-
Property Sales	9	9	6	9	9	3	-
Management Assistance	416	416	364	416	416	52	-
Program Direction	121	121	108	121	121	13	-
Counseling	173	173	156	173	173	17	-
Training	52	52	46	52	52	6	-
Small Bus. Dev. Centers	23	23	18	23	23	5	-
Program Support	27	27	21	27	27	6	-
International Trade	20	20	15	20	20	5	-
Financial Assistance	1,721	1,721	1,654	1,721	1,999	67	278
Program Direction	134	116	100	116	116	16	-
Guaranty Lending	404	388	358	388	388	30	-
Direct Lending	149	83	73	83	83	10	-
Disaster Assistance	6	6	6	6	6	-	-
Portfolio Management	945	1,040	1,040	1,040	1,318	-	278
Lender Relations & Cert.	83	88	77	88	88	11	-
Investment Assistance	85	85	83	85	85	2	-
Investment	35	35	33	35	35	2	-
Special Guarantees	50	50	50	50	50	-	-
Minority Small Business-COD	367	367	360	367	367	7	-
Program Dir. & Other MSB	91	91	88	91	91	3	-
Bus. Dev. - 8(a)	225	225	223	225	225	2	-
Bus. Asst. - 7(j)	51	51	49	51	51	2	-
General Counsel	378	378	370	378	378	8	-
Policy, Planning & Budgeting	194	194	180	194	194	14	-

PERSONNEL (CONTINUED)

Decision Unit	FY 1981 Estimate	FY 1982 Estimate	FY 1983 Reduced Level	FY 1983 Current Level	FY 1983 Requested Level	Reduced to Current	Current to Requested
Advocacy	46	46	44	46	46	2	-
Advocacy	21	21	21	21	21	-	-
Economic Research	13	13	13	13	13	-	-
Women's Bus. Enterprise	12	12	10	12	12	2	-
Cong. & Legis. Affairs	14	14	13	14	14	1	-
Public Communications	29	29	28	29	29	1	-
Personnel Management	49	49	46	49	49	3	-
Field Services	33	33	32	33	33	1	-
Data and Management Svcs.	201	201	187	201	219	14	18
Data Management	121	121	111	121	139	10	18
Management Services	80	80	76	80	80	4	-
Equal Employment Oppor. and Compliance	45	45	45	45	45	-	-
Inspector General	144	144	120	144	175	24	31
Executive Direction & Field Administration	623	623	585	623	623	38	-
Total	4,558	4,558	4,307	4,558	4,885	251	327

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

SEP 24 1981

Honorable Michael Cardenas
Administrator
Small Business Administration
Washington, D.C. 20416

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OFFICE OF THE ADMINISTRATOR

Dear Mr. Cardenas:

This letter provides Presidential policy guidance for preparation of your fiscal year 1983 Budget.

When the President submitted his 1982 Budget in March, he made clear that substantial additional reductions in 1983 and future year agency estimates would be necessary to assure that we would continue on the path to a balanced budget by 1984. The 1982 Budget included a commitment that we would identify an additional $30 billion in budget savings for 1983 and $44 billion for 1984.

Also, higher than expected interest rates and other developments have made it necessary that 1982 Budget requests be reduced and that, as a minimum, in the targets for 1983 and 1984 additional savings must be achieved. All agencies will need to share in the reductions.

As you are well aware, the President is committed to the task of holding the 1982 deficit to $42.5 billion and to achieving a balanced budget by 1984. With the exception of a very few accounts, the President has decided to propose across-the- board 12% reductions in his 1982 Budget requests now pending before the Congress. Specifics on the 1982 reductions will be provided soon.

Also, the President has decided upon new outlay ceilings reflecting the additional budget savings necessary to achieve his goals. The enclosure contains the outlay ceilings for your agency for fiscal years 1983 and 1984. These ceilings are net of proprietary receipts.

Achieving the President's economic objectives may require reductions below the outlay planning ceilings identified. In addition, the final determinations on the amounts to be included in the 1983 Budget depend on factors that cannot be known with certainty now, such as Congressional action or inaction on Presidential proposals and the economic and international outlook as it will appear this fall.

The President has also decided to achieve substantial reductions in federal civilian employment starting in fiscal year 1982. You will be notified of the 1982, 1983, and 1984 targets for your agency within a few days.

A review of federal credit programs is now underway and specific ceilings will be decided shortly. These ceilings will also be provided soon.

The President's 1982 Budget included a commitment to step up debt collection activities so as to obtain an additional $1.5 billion each year. Your agency's target for 1983 has been increased in the amount provided on the enclosure. Income from debt collection should not be counted as a part of the budget savings that will be needed to achieve your outlay ceilings.

It will be necessary for your agency to proceed expeditiously with revised budget requests reflecting these enclosed ceilings. Your budget requests should represent the most desirable mix of programs that can be devised to achieve the President's major policy and program objectives and the most realistic way to keep within these planning ceilings.

Your agency's budget requests reflecting the enclosed outlay levels must be received by OMB no later than October 5, 1981. Your cooperation in this effort is greatly appreciated.

Sincerely,

David A. Stockman
Director

Enclosure

Enclosure

SMALL BUSINESS ADMINISTRATION
(In millions of dollars)

Budget Planning Ceiling

	1983	1984
Outlays (net)	260	303

Increase in Debt Collection Target

	1983	1984
Net increase in collections from non-government sources	175	175

Senator WEICKER. Do you have any further questions of this witness, Senator Hayakawa?

Senator HAYAKAWA. No, I do not.

Senator WEICKER. Thank you. You might want to stay a while and listen to the opinions of those who are the beneficiaries of the Administration's policies toward the small business community.

The first panel consists of Mr. Sower, Washington director of the National Association of Development Companies; Mr. Eben Graves, Jr., of E. M. Graves Investment Companies, Southport, Conn.; and Mr. Anthony E. Cone, vice president of Blyth, Eastman, Paine Webber, San Francisco, Calif.

The statements of all the witnesses, in their entirety, will be placed in the record following the oral presentations. I would ask that the witnesses, because of the number we have, either synopsize their statements or keep them within a moderate time.

Have I left somebody out? I called three names, but I see four people. I want to make sure I have everyone.

Mr. RASHED. My name is Haazim Rashed. I am with the New Haven Community Investment Corp., an SBA-certified development company. I am offering supporting testimony.

Senator WEICKER. Fine. Gentlemen, please proceed in any way that you see fit.

STATEMENT OF JOHN SOWER, WASHINGTON DIRECTOR, NATIONAL DEVELOPMENT COUNCIL AND INCORPORATING PRESIDENT, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES, ACCOMPANIED BY E. M. GRAVES, JR., E. M. GRAVES INVESTMENT COMPANIES, SOUTHPORT, CONN.; ANTHONY E. CONE, VICE PRESIDENT, BLYTH, EASTMAN, PAINE WEBBER, SAN FRANCISCO, CALIF.; AND HAAZIM RASHED, SMALL BUSINESS SPECIALIST, CITY OF NEW HAVEN AND NEW HAVEN COMMUNITY INVESTMENT CORP.

Mr. SOWER. I will start, Senator.

I am Washington director of the National Development Council and incorporating president of the National Association of Development Companies, which is a professional trade association for the

section 503 certified development company program. I am with Haazim Rashed, who has been introduced.

I do have a written statement which has been submitted, and I will summarize it. In a one-sentence summary, the message is that unemployment is very high, as we all know, and the 503 program is one of the most cost-effective ways that exists to create jobs in the private sector. Hopefully, my presentation will be a chain of logic, like high school geometry, with the problem and several alternatives and our recommendations.

The first is that the economic conditions of unemployment nationwide make it important to create jobs and also to reduce unemployment payments which are unfavorable on the deficit. As a policy alternative, the administration is recommending tax cuts and has implemented tax cuts which in fact will be helpful for small businesses. There is some disagreement on the timing of the impact of the tax cuts, as to how long it will take to stimulate the economy.

As evidence, we can look at the venture capital business and a recent Business Week article. I am talking about the reduction in the capital gains rate. It talked about how the venture capital business is now about $1 billion a year, when in fact a few years ago it was very low.

Senator WEICKER. I want to make one point clear, Mr. Sower, that as far as some of the business tax cuts, the administration deserves credit. As far as that portion of the tax cut which included the reduction of 2 percent in the lowest two brackets, the small business community can thank the Congress of the United States. That was not an administration initiative.

Mr. SOWER. Thank you, Senator.

There has also been a discussion of the situation in England, where they have used tax cuts to try and stimulate the economy, and the discussion is on the delays and the concern about the delays.

From our viewpoint, the overlooked policy alternative is small business. We have all seen the evidence of the David Birch study, saying that two-thirds of all new jobs are in small businesses with under 20 employees. President Reagan stated that 80 percent of all new jobs comes from small business. There are statistics that the Fortune 500 companies created zero or very few new jobs in the decade of the seventies.

We all know the arguments in favor of small business, in terms of innovation, productivity, and maybe a third factor which does not get us much publicity, which is the response time of small business. They can respond much more quickly to changes in the economic environment than large corporations. It is sort of like, using a football analogy, if you are 14 points down in the fourth quarter, and you have a choice of several running backs, it is not time for a random or a democratic choice of the running backs; you want to go with your fastest one, which in fact in today's economy is small business.

There are some problems that small business has with interest rates and many other problems. But the major problem that we focus on is growth capital for expanding small businesses. One of the ironic points that we deal with all over the country is that

healthy, profitable small businesses cannot get expansion capital for their businesses. In finance we learn that all expanding corporations need capital: A.T. & T., ITT, GTE, and so on, need continuous outside capital for the growth of their business, whether it is stocks or bonds from Wall Street or what have you. They need it for working capital, and they need it for fixed assets.

The tax cuts will help, but in fact, particularly for small businesses, there are gaps in terms of getting growth capital for their business. If you go down a check list of available sources of capital in the economy, all small businesses have banks, but banks are predominantly short-term lenders not long-term lenders. Savings and loans are required legislatively to be primarily residential lenders and in today's economy are not active. Pension funds and insurance companies prefer larger deals. Going back to the checklist of debt financing, we exclude most sources of capital in the economy for long-term capital for smaller businesses.

On the equity side, most small businesses start with equity investments from friends and relatives, but in fact they are too small for most investment bankers who want larger projects. The venture capital industry is very active, but frankly they want the cream of the crop, and the venture capital industry is not looking for the steady expanding small business.

So in conclusion, on the issue of the growth capital for smaller businesses, it is the SBIC program and the section 503 program that are the Government's most effective tools for creating jobs. They in fact do use totally private capital. They use capital from banks and other private sources, and they use capital from long-term sources, using the Government guarantee as a mechanism of reaching long-term capital for small business. Yet they are totally overlooked as a policy focus to stimulate the economy.

A couple other sentences on the cost effectiveness of these types of programs. I am going to switch hats for a second to my National Development Council hat. We have created 130,000 jobs in the economy in small business in the last several years, 3,000 small businesses in particular. It is the 502 and 503 and many other similar programs. Our statistics show that it takes about $15,000 of investment in small business to create one job. Of that, 84 percent or some $13,000 is private capital, and the remaining $2,500 is Government capital, essentially from a Government guarantee. Actually, it is Government-guaranteed private capital.

So what we are talking about as an alternative way of creating jobs is a $2,500 one-shot Government-guaranteed loan versus all the other alternatives, which are unemployment payments, make-work programs, welfare, or some would even say crime, which in fact runs at $15,000 to $25,000 per job, per year, every year. That is how the numbers break out to us, and we feel that the 503 program and the similar programs are far more cost effective.

Our recommendation, of course, is that the 503 funding level be retained at the current level and in fact that a more aggressive policy approach be taken to create jobs in the economy using these kinds of private-sector programs. Thank you, and I will turn it over to Mr. Rashed.

Mr. RASHED. My name is Haazim Rashed. I am the small business specialist for the New Haven Community Investment Corp., a

certified development company under the SBA 503 loan program. We were certified in July of 1981, and since that time we have been actively participating in the 503 program. We have approved loans at this point that total on the SBA portion $310,000. In real investment terms, it represents $1 million commitment in loans.

We have, through our efforts, indications—or at least our record shows—that for each SBA expenditure, we get one job created for $2,200 in SBA funding. We are looking in the future to process approximately $5 million in total financing with $2 million of SBA-guaranteed debentures, and we feel that any reduction in the SBA 503 funding level will decrease the possibility of small business employment growing in our area.

As one of our local bankers has said about the SBA 503 program, a Mr. Joseph Virelli of First Bank of New Haven, he was quoted as saying, "I'll do as many 503 loans as I can. They are good for the bank and good for the small business." Now, Mr. Virelli works with a number of small businesses, and he feels this is one way he can help his clients. Many times a business comes to a bank and needs more financing than they would normally qualify for. Under the SBA 503 program, we can give them the financing they need, and they can create the jobs that we as a city in the declining Northeast need. Thank you.

Senator WEICKER. Thank you very much, Mr. Rashed.

Mr. Cone?

Mr. CONE. My name is Anthony Cone, vice president of Blyth, Eastman, Paine Webber, the stock brokerage and underwriting firm. I am housed in San Francisco. Although I am going to discuss my program experience regarding the SBA's pollution control guarantee program in California, I do operate all over the Nation and have experience elsewhere, which I will document. I will limit my remarks specifically to that program, for that is the sole reason why I am here.

My personal involvement with the program began in 1977, soon after the legislation passed that enabled the SBA to guarantee pollution control debt. I have utilized SBA guarantees entirely and solely with tax-exempt financing, as I believe the program has nationally. We did the pilot program, and I underwrote it while previously with the Bank of America in California, and that set the pattern by which I believe the program has operated all over the country since.

Of the approximately 233 companies that have been financed to date, I have personally underwritten the needs of 113 of them nationwide. I have underwritten financings in nine States. The principal activity for me has been in California and second in Michigan. Of the 233 companies underwritten nationwide, 78 of those have been in California.

Briefly, I think it has been a very valuable program and something that has filled a need that otherwise is not going to be met. Most commercial banks are, in my experience, hesitant to lend money for pollution control facilities because they are nonproductive. Only the strongest of credits can borrow money for these purposes, and small businesses that are able to convince their banks to lend for nonproductive facilities are only able to borrow for short periods of time—3, 5, or perhaps 7 years—of course, at taxable in-

terest rates, as opposed to the tax-exempt which is utilized for this program, and those rates traditionally have been at least 2 or 3 percent above prime, usually floating, and right now I am sure would be at least 23 to 25 percent.

It is interesting that in California the California pollution control financing authority has been selling taxes and revenue bonds for pollution control needs for companies since 1972, when the legislature enacted that program, and there have been 78 businesses utilizing the SBA guarantee, but only 44 or 45 large corporations have sold bonds during that period for like purposes. I think it indicates how valuable and how strong the program has been, both in and to California.

Another of the concerns that I have this morning, which I will address briefly, is that the Office of Management and Budget has recently insisted that the SBA stop utilizing this program for guaranteeing loans that are being financed with tax-exempt debt and, rather, only finance loans that are financed with taxable debt. What concerns me greatly is that that comes at a particularly crucial time and difficult time for small businesses to bear the brunt of financing what in the first place, as I indicated, are nonproductive publicly mandated facilities.

Right now, the tax-exempt rate for a 10-year debt would be about 11¼ percent with the SBA guarantee. If bonds were to be issues taxable, it would be about 14 percent, clearly an incredible difference of 275 basis points or 2¾ percent. At the 20-year rate, it would be 13 percent tax-exempt and approximately 14 percent, once more, taxable. And then the spread narrows at 30 years at 13¼ percent for tax-exempt and perhaps still 14 percent taxable.

A unique situation exists in the market right now, where you will note that the taxable rate that I quoted was approximately 14 percent through all the 10-, 20-, and 30-year maturities. We have not issued bonds with the SBA guarantee that are taxable. We do not have any experience. I do not think anybody has done one yet, but these are our best estimates today.

The difference in these rates is felt greatest by, of course, the smallest businesses. In California, our experience has been that although this program allows debt to be guaranteed in principal amount up to $5 million per company, that specifically at least half of the businesses financed in California have needed $500,000 or less. Those are the companies who would be hardest hit by these rate changes. They are the ones who take the most advantage of this program and utilize it the most, I believe nationwide as well.

The problem with the rate change, further, is that not only does it raise the amount to be paid each month by the company, but furthermore the guarantee fee that the SBA charges escalates terribly. As you may know, the guarantee fee is charged on principal and interest, because it is a 100-percent guarantee, and the effect is to raise the effective interest rate from 14 percent borrowing, for example, to 17 or 17½ percent to the borrower.

That, at a fixed term, is very difficult for many of the small businesses that we finance to finance, and I believe further would probably result in a tremendous decline of the use of this program and perhaps in some businesses failing, not only in California but particularly in places like Michigan—again, the State which I believe

has utilized the program the most, second to California, of any State in the country.

I want to say that I have just spent 2 days discussing tax-exempt and other financing of companies in the Pacific Northwest, and the unemployment rates that are being advertised in Oregon are currently 12 percent, and 21 percent in the lumber industry and others indicate that there will be a lot of businesses failing. I think this program can help keep some from doing so.

I would say finally that the previous panel discussed, to some extent, the lack of demand for many of their programs and for borrowing and credit in general. I think that you may see a lack of demand in this program if for no other reason that companies that are applying cannot stand the 6 months to 1 year wait which results in many cases to get a response from the SBA, let alone approval. Many companies we had approved in the end of 1980 were financed in California in November of 1981, an 11-month wait because of the allocation problems and because of the fact that the SBA was limited in dollar amounts.

I think it is crucial that this program not only be authorized and enabled to go to much greater dollar amounts—a minimum of $250 million a year, and I think it ought to be more—but furthermore proper staffing and proper administration has to be attended to. I will conclude with that.

Senator WEICKER. Thank you very much, Mr. Cone.

My old personal friend from Southport, Eben Graves.

Mr. GRAVES. Mr. Chairman, my name is Eben M. Graves, Jr. I am the president of E. M. Graves Investment Advisory, Inc., a Connecticut-based investment advisor to public and private retirement funds.

I am a small businessman who invests pension assets in small business. I am here to tell you today that Reaganomics does not work. It does not work. It does not work at all. Specifically, this administration's adopted policy of eliminating Federal loan guarantee programs is going to destroy the ability of small and rural business to raise term capital. This administration is definitely anti small business. In absolute numbers, they are anti 90 percent of American business and 85 percent of employment.

What this administration should be doing and what the Congress of the United States will be doing is to implement and adequately fund programs which will stem the tide of rapidly escalating unemployment. The consulting economists that advise my firm are estimating that our national unemployment will move from its 8½ percent current rate to 10 percent or higher in fiscal 1982. In 1933, Mr. Chairman, the top level of unemployment in this country was 12 percent nationally. We are 2 percent away from 1933.

How can Congress now put people to work without creating the incredible ruinous deficits projected by the administration of $109.1 billion in fiscal 1982 and moving all the way up to $162 billion in fiscal 1984. There are two budgets, one of which the administration likes to talk about, and another budget which is a shadowy budget, a budget not fully understood, perhaps even by the Congress of the United States. There was an article in the New York Times Sunday Magazine which was so full of misstatement or just plain lack of knowledge that it was the first time I have ever replied by

writing a letter to the editor of the New York Times. I usually do not do that; it is an exercise in futility.

They took the popular low road that said, if the Government loans money to somebody, it must be a mortal sin, or you must be a woman, a black, disadvantaged, or in some way crippled. The Government, in fact, under the Federal loan guarantee programs, is not loaning money to anybody. They are simply making a massive guarantee. They are not loaning a dime. They are allowing a bank to make a term loan to a small or rural business.

Now, there are two small business lending programs that run very, very well. One is in the Department of Agriculture, called the farmers loan business and industry program. The other is in the Small Business Administration, called the SBA section 7(a) business and industry loan guarantee program. Here are OMB statistics on those programs. I am going to rapidly shorten my testimony.

The Farmers Home Administration loans money to the same type of credits that the Small Business Administration does, except that they have to be in population areas of 50,000 or less. The Farmers Home Administration to date has lent $3,546,397,621 in closed loans from fiscal 1977 to December 1981. Those loans represent a 1-percent guarantee fee collected on those loans. The Government collected 1 percent. Those loans defaulted at a rate of 1.16 percent. You and I, the taxpayers of the United States, are out 1.16 percent. That little tiny program created 273,000 jobs, at a cost per job of $33.30. That is a figure that Mr. Stockman and I worked out; that is an OMB figure.

The reason that this administration would like to eliminate the farmers home business and industry guarantee program is because it is the most cost-effective loan guarantee program in Government. It is the most cost-effective program in Government.

The next program, in the Small Business Administration, has been around since the Truman administration. This program has put out to date $22,400,000,000 worth of loans under section 7(a). The default rate has been 3.9 percent. There is a loan guarantee fee collected of 1 percent on this program also. The SBA figures that they create, with every $25,000, something like one job. So they have created roughly 112,200 jobs out of the $22.4 billion in loans made.

I run pension assets. What the pension system of this country needs is a better higher-yielding Government security. What these programs do is to recycle for free the savings consumption, capital from the savings consumption of the country, the pension funds, through the banking system, back into investments in small and rural businesses. If these programs are cut, this recycling will end, and you will have greater unemployment and higher budget deficits. These programs do more good than the administration would like to give them credit for.

That is the end of my statement, sir.

Senator WEICKER. Senator Hayakawa?

Senator HAYAKAWA. I am very grateful to both Mr. Cone and Mr. Graves for their comments. If you will permit me, Mr. Chairman, I would like to address my questions to both of them.

Senator WEICKER. Certainly.

Senator HAYAKAWA. First of all, I would like to submit for the record a statement I made in response to Mr. Cone's testimony. The program he is talking about is something that Senator Carl Levin and I have been interested in. We introduced it. I think we can call it our "baby."

Senator LEVIN. What are we going to do next year without you, Sam?

Senator HAYAKAWA. I don't know. At any rate, the program has been successful. As you say, the administration has submitted a recommendation that would prove so harmful to the pollution control bond guarantee program that it will become ineffective. In other words, what you are saying, if I understand you, is that this program which has been successful, which has helped small business significantly, is in danger of being rendered ineffective or eliminated. Is that correct?

Mr. CONE. Yes, sir, by virtue of greatly increased costs, fewer applicants, and those applicants that do utilize the program will suffer a severe cash flow disadvantage and perhaps any profitability will be severely impaired. In some States, I might add, most of the current applicants will not be able to take advantage of the program because they will not be able to afford it.

Senator HAYAKAWA. Mr. Cone, I am very grateful to you for your statement and your analysis, and I would like to put my remarks on this subject into the record.

Senator WEICKER. The remarks of the Senator from California will be included in the record at this point.

[The prepared statement of Senator Hayakawa follows:]

STATEMENT OF SENATOR S. I. HAYAKAWA

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 23, 1982

MR. CHAIRMAN,

THE SMALL BUSINESS ADMINISTRATION'S (SBA) POLLUTION CONTROL GUARANTEE PROGRAM WAS INITIATED BY CONGRESS IN 1976 AND HAS EARNED OUR CONSISTENT SUPPORT SINCE THAT TIME. IT IS ONE OF THE MOST SUCCESSFUL LOAN GUARANTEE PROGRAMS IN THE HISTORY OF THE AGENCY AND IT SERVES A PARTICULAR NEED FOR SMALL FIRMS THROUGHOUT THE COUNTRY BY PROVIDING THE ONLY AVAILABLE LONG-TERM, LOW INTEREST LOANS TO FINANCE GOVERNMENT-MANDATED POLLUTION CONTROL DEVICES. ACTUALLY, THE HISTORY GOES BACK TO 1973 WHEN CONGRESS RECOGNIZED THE GROWING NEED TO HELP SMALL BUSINESSES COMPLY WITH STATE OR FEDERAL ENVIRONMENTAL STANDARDS WHEN IT BECAME EVIDENT THAT STANDARD LOANS WERE TOO COSTLY FOR THEM.

THE PURPOSE OF THE PROGRAM IS TO ASSIST SMALL FIRMS TO COMPLY WITH GOVERNMENT REGULATIONS THAT CREATE NONPRODUCTIVE, FINANCIAL BURDENS FOR THEM. THE PROGRAM ACHIEVES THIS GOAL, HELPS TO SAVE JOBS, AND PERMITS SMALL FIRMS TO USE THE PRIVATE CREDIT MARKET AND INVEST IN PRODUCTIVE EQUIPMENT AND FACILITIES.

IT WAS A SUCCESS FROM THE BEGINNING. THE PRINCIPAL REASON FOR ITS SUCCESS IS THAT IT REQUIRES COOPERATIVE PARTICIPATION OF THE PRIVATE SECTOR -- SMALL BUSINESSES, LOCAL BANKS, BOND UNDERWRITERS, AND LOCAL AND STATE ENVIRONMENTAL OFFICIALS -- TOGETHER WITH THE FEDERAL GOVERNMENT, THROUGH SBA'S LOAN GUARANTEES.

ON FEBRUARY 26, 1981, SENATOR CARL LEVIN, A MEMBER OF THIS COMMITTEE, AND I INTRODUCED THE POLLUTION CONTROL FINANCING ACT OF 1981 (S. 580). THIS LEGISLATION WAS PRECEDED IN 1980 BY LEGISLATION WE INTRODUCED IN A SIMILAR FORM THAT THE SENATE APPROVED BUT THE HOUSE DID NOT APPROVE. SINCE WE BELIEVED SO STRONGLY IN THE PROGRAM, AND DID NOT BELIEVE THE HOUSE'S FAILURE TO PASS THE LEGISLATION INDICATED DISFAVOR WITH ITS INTENT, WE REINTRODUCED IT. THE BILL PROVIDED THAT THE PROGRAM BE RAISED FROM $110 MILLION TO $250 MILLION. THE REASON FOR RAISING THE LEVEL WAS BECAUSE THE PROGRAM PROVED SO SUCCESSFUL THAT IT WAS OVER-SUBSCRIBED.

IN MAY OF 1981 THIS COMMITTEE HELD A HEARING ON S. 580. AT THAT TIME, THE ADMINISTRATION RECOMMENDED THAT THE PROGRAM LEVEL FOR FISCAL YEAR 1982 BE REDUCED TO $95 MILLION. NOTWITHSTANDING THAT RECOMMENDATION, THE COMMITTEE AGREED TO INCLUDE THE $250 MILLION AUTHORIZATION IN THE OMNIBUS RECONCILIATION ACT OF 1981. THE SENATE ACCEPTED THE COMMITTEE RECOMMENDATION: THE CONFEREES AGREED, AND THE PRESIDENT SIGNED THE ACT INTO LAW. LATER THAT YEAR, THE ADMINISTRATION ONCE AGAIN LOWERED THE CEILING ON THE PROGRAM TO $50 MILLION FOR FY 1982, ATTEMPTING

TO SUBVERT CONGRESSIONAL AUTHORITY AND COMPLETELY IGNORING THE INTENT OF THE STATUTE.

IN ANSWER TO THIS LATEST ACTION BY THE ADMINISTRATION, ON NOVEMBER 12, 1981, SENATOR LEVIN AND I INTRODUCED AN AMENDMENT TO PLACE THE CEILING AT NOT LESS THAN $175 MILLION TO ASSURE THAT THE INTENT OF CONGRESS AS EXPRESSED IN LAW WAS CLEARLY UNDERSTOOD AND IMPLEMENTED. THE AMENDMENT WAS ADOPTED. WHEN THE HOUSE OF REPRESENTATIVES SENT IS CONTINUING RESOLUTION TO THE SENATE IN DECEMBER, HOWEVER, THE LANGUAGE IN SECTION 136 OF H. J. RES. 370 WAS AMBIGUOUS ENOUGH TO REQUIRE A COLLOQUY BETWEEN MY COLLEAGUE LOWELL WEICKER, CHAIRMAN OF THE SUBCOMMITTEE ON STATE, JUSTICE AND COMMERCE APPROPRIATIONS, AND CHAIRMAN OF THE SENATE SMALL BUSINESS COMMITTEE, AND MYSELF TO ASSURE THAT THE FULL FUNDING LEVEL OF $250 MILLION COULD BE FOLLOWED BY SBA PROGRAM OFFICIALS.

NOW, ONCE AGAIN, THE ADMINISTRATION HAS SUBMITTED A RECOMMENDATION THAT WILL PROVE SO HARMFUL TO THE POLLUTION BOND GUARANTEE PROGRAM THAT IT WILL BECOME INNEFECTIVE. IN ADDITION TO REQUESTING ONLY $150 MILLION PROGRAM LEVEL ($100 MILLION BELOW THE AUTHORIZATION LEVEL), SBA WILL NOT BE PERMITTED TO GUARANTEE BONDS THAT INVOLVE TAX EXEMPT FINANCING, AS IT HAS DONE SINCE THE PROGRAM BEGAN. EXCLUSION OF TAX EXEMPT FINANCING MAY, IN FACT, SIGNAL THE END OF THE PROGRAM.

I COULD UNDERSTAND THE DESIRE TO REDUCE THE SIZE OF THE PROGRAM IF IT WAS INEFFECTIVE, OR IF THERE WAS RAMPANT ABUSE, OR IF THE DEFAULT RATE WAS EXCEPTIONALLY HIGH, OR IF THERE WAS NO DEMAND FOR IT. HOWEVER, NONE OF THESE IS THE CASE. ON THE CONTRARY, THE ACTING ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT OF THE SBA TESTIFIED BEFORE THE HOUSE SMALL BUSINESS COMMITTEE LAST NOVEMBER THAT THE PROGRAM IS COMPLETELY EFFECTIVE, NEEDED, AND SUCCESSFUL.

CONGRESS HAS BEEN CONSISTENT IN ITS SUPPORT OF THE PROGRAM AND IN SUPPORT OF RAISING THE PROGRAM LEVEL TO MEED THE NEEDS OF SMALL BUSINESSES. IT IS MY HOPE THAT THOSE WITHIN THE ADMINISTRATION WHO HAVE ATTEMPTED TO LOWER THE CEILING AND HAMPER THE EFFECTIVENESS OF THE PROGRAM WILL CONSIDER THE TESTIMONY BEFORE THIS COMMITTEE TODAY AND RESTORE THE PROGRAM TO THE LEVEL IT DESERVES AND WHICH CONGRESS AUTHORIZED.

THANK YOU, MR. CHAIRMAN.

# # #

Senator HAYAKAWA. I would also like to ask Mr. Cone what is the current need for the SBA pollution control program in California, in terms of the number of qualified businesses that could utilize the program and the total dollar value of the contracts that could be guaranteed?

Mr. CONE. We currently have 24 applications pending at the SBA, some of which have been approved, very few of which have been approved, the rest of which are waiting to be analyzed and a determination made. Those 24 companies have total needs of $33 million. We have an additional, in my opinion, of another 25 to 30 companies that are going to apply soon, meaning in the next couple of months, but quite frankly we are not pushing them because there are already more applications, both approved and pending, nationwide in the SBA offices than the demand rather than the authorization can satisfy.

I believe that it is very difficult to calculate the total need in California or any State. This program has been so severely understaffed and underfunded for the last year that most of the underwriters involved in this program in the Nation have slowed their efforts to develop new applicants. I certainly have. How many times can I ask a company to wait a year to have funding, when about two years ago we often funded companies in anywhere from 8 to 16 weeks from the date we actually applied to the SBA. That kind of a change has made it impossible for most of us to pursue applicants with great fervor. I think the demand is almost incalculable as a result, but great.

Senator HAYAKAWA. Thank you, Mr. Cone. What you say is really very disturbing.

I find Mr. Graves' testimony disturbing, too. I have been under the impression, as a strong supporter of Reaganomics and his frequent flattering remarks about small business, that he is a friend of small business. As he has said often, new jobs are created by small business. His own program of accelerated depreciation, of investment in business for automobile and trucks, for manufacturing machinery and buildings, all the accelerating writeoff have seemed to be of great help to small business as well as to large businesses. These are the points in Reagan's program that I have focused upon as being helpful to small business.

But what you say about the Farmers Home Loan business and industry program, the Small Business Administration's section 7(a) business loan program, and the lack of support and cutting back on these is profoundly disturbing. When you say the Reagan administration would like to forget about these programs because their success is an embarrassment to the administration, and you quote Richard Lyng, Undersecretary of Agriculture, as saying, "If the success of these programs was widely known in Congress, the administration knows it would have trouble cutting other Federal programs." You say that this is a direct quote from Mr. Lyng.

That seems sort of an illogical statement for Mr. Lyng to make. If the success of the program was widely known to Congress, the administration might very well want more programs of the same kind as these.

Mr. GRAVES. This, Senator, is what is known as throwing the baby out with the bath water. If you want to change the tempera-

ture of the bath water or let a lot of it out of the tub, you had better throw the baby out right away. If you have a very good program, and you want to cut Federal loan guarantee programs across the board, you have to sublimate the information on the good programs, which the administration has been doing, really doing as much as possible to forget about and downplay the successful programs so that they can cut across the board.

In the case of SBA, there is a definite slowdown in the loan making situation that is going on right now. Last year this time, fiscal year 1981, the SBA had 7,578 loans obligated. Those loans totaled $988 million. In the first quarter of fiscal year 1982, the SBA has 2,803 loans, with a total number of dollars obligated, $346 million—these are section 7(a) loans only. We happen to know that as of January 31, there were about $500,100,000 loans which were approved but undisbursed. In Farmers Home, there was $1 billion worth of approved undisbursed loans.

These are companies that have had their credit passed on at two levels of due dilligence: one at a bank and two by the Government. This administration's accelerated depreciation, Senator, helps all business, big and small. But this administration, it seems, either by error of omission—but I think it has gone on too long—is really trying to destroy the only source of term capital to small and rural business, which is a term loan guaranteed by a government agency made through a bank.

Senator HAYAKAWA. On your page 3, you talk about this program which creates a large number of jobs and the cost-per-job-created has dropped from $55.36 to $33.30. That is a remarkable figure.

Mr. GRAVES. That is true. In my testimony before the House Agriculture Committee last year, the man who testified after me was the treasurer of Chrysler Corp. He testified that the cost to Chrysler per job was $12,000.

Senator HAYAKAWA. I am accustomed to figures like that in this context. How do you account for the fact that you can create through Farmers Home Administration this kind of job with so small an investment?

Mr. GRAVES. I think the answer to the question is in some of the enterprises, like rural factories and large numbers of people employed, there might be a chicken processing plant, or it might be a pork processing plant, or it might be a slaughterhouse, where you might have 5,000 or 6,000 people employed.

Senator HAYAKAWA. It is technologically very different from the Chrysler plant.

Mr. GRAVES. That is true. It is hand-work business. That is one of the explanations.

Senator HAYAKAWA. Then again, in SBA, you say the number of jobs created was 112,200 and the cost per job was $2,375. That again is a remarkably low figure for the creation of jobs.

Mr. GRAVES. True.

Senator HAYAKAWA. What you seem to be saying, sir, is that the present administration's enthusiasm for cutting costs is not only cutting the cost of wasteful programs but cutting indiscriminately——

Mr. GRAVES. That is true.

Senator HAYAKAWA [continuing]. Programs that are extremely popular, extremely useful, extremely helpful to the economy; is that what you are saying?

Mr. GRAVES. Yes, sir, that is what I am saying. When they started cutting, they did not look too thoroughly at what they were cutting. These two programs, Senator, should be expanded.

Senator HAYAKAWA. Yes, if you are right with these figures——

Mr. GRAVES. These are OMB figures. I do not know whether Mr. Stockman is making good ones this year or not. He has had some problems there before. But right now they seem to be the figures that were released. They have been checked by us, and they have also been substantiated by the General Accounting Office, which has the same numbers.

What the administration should be doing and what it is doing are two different things. What the administration should be doing is to expand these programs because they do not cost anything. They are not the type of programs described in this New York Times article, which is mandatory reading, I think, for everybody here.

Senator HAYAKAWA. What is that article?

Mr. GRAVES. This is the Sunday Magazine section of the New York Times, February 21, 1982.

Senator HAYAKAWA. In your last paragraph, you say that this Administration—has done everything possible to destroy the ability of small business, which is 90 percent of American business, to raise term capital. When you write that, I am reminded of what George Gilder has said in his writings very frequently, that big business news in the business pages is the news of mergers of big companies, but those mergers do not create jobs. In fact, they may eliminate some. Whereas, as you say, the poultry processing plant can be creating hundreds of jobs without rating a line in the business pages of the Washington Post or the San Francisco Chronicle; is that true?

Mr. GRAVES. That is true.

Senator HAYAKAWA. This is what happens as a result of the Farmers Home Administration's loans and the Small Business Administration's loans. The little outfits that do not make business news, that do not get big writeups in Barron's, those are the places where the real growth is taking place.

Mr. GRAVES. True.

Senator HAYAKAWA. I am very, very grateful to you, Mr. Cone, for your testimony.

Thank you, Mr. Chairman.

Senator WEICKER. Thank you, Senator Hayakawa.

We have to move along and let Senator Levin ask his questions, but I just want one brief question, Eben, to you, which is this. The statement made, both as far as small business is concerned but also in other areas, that the non-Federal sector is going to take up the slack with regard to the small business community. You are the non-Federal sector. Will you take up the slack if we bail out of all this?

Mr. GRAVES. If there were no Federal loan guarantees on this paper, be it SBA, FAA, or what have you, the ability of the banks to make a loan more than 1, 3, or 5 years—the appetite of the

bank; I should not say the ability. They have the ability. Their appetite would be zero, because these types of loans are a business-oriented Government national mortgage-type loan, where the bank can make the loan and can sell the loan, which is probably good for the bank and gets the borrower his term capital and it gets the pension fund, which I represent, a guaranteed Government-secured investment.

The answer to your question is, if these programs were eliminated, things are bad enough now, but I think you would see a real disaster.

Senator WEICKER. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman.

I want to ask you just a few questions, Mr. Cone, about the pollution control authorization level, something that Senator Hayakawa and I were very much involved in. Last year, with the help of the chairman and others, we were able to get an authorization for this program to a level which we thought made some sense at the time, $250 million.

Now, first of all, is there a demand for that level of authorization?

Mr. CONE. I think there is a demand for that level and more.

Senator LEVIN. I think the chairman will remember, and I know that Senator Hayakawa will remember, what happened after we authorized the $250 million from this program last year. What happened is that the OMB came along and, as part of a program to reduce the level of government-guaranteed loans, unilaterally reduced the level after the Congress had spoken. Are you familiar with that history?

Mr. CONE. I am very familiar with it. Furthermore, I might add that the SBA program chief in charge of issuing these guarantees and administering the program—I might add a fellow who is the sole staff for more than 3 years of the 5½ years history of this program, literally without secretarial assistance most of the time—had already issued guarantees for the fourth quarter of last year and was working on the first quarter of this year's $250 million allocation, was stopped by OMB and more directly by his administration and told immediately to halt processing guarantees.

Senator LEVIN. That happened on November 5, when the OMB came along and said, "The Congress may have said $250 million, folks, but we are saying $50 million." They went down a whole list of programs, not just in SBA, although four of them were in the SBA inventory, but in other agencies as well. They came along and said, "Congress said $1.1 billion, and we say $700 million." We tried to repair this and had some success with the pollution control. With the help of the chairman, we were able to get a floor established through an amendment to another bill still pending in the Senate.

There are really two issues. One is the authorization level of these programs and these cuts. I think that this one issue is a critical issue. I happen to agree that the cuts in these programs to small businesses are counterproductive. They are not at all cuts in waste. I will not give those other words; this committee has heard enough from me on this subject. They are not cuts in wasteful programs; they are cuts in productive programs.

But that is only step one. And after we make the decision on this, we hear from OMB, and they say, "Reduce it." We hear from the community, and they say, "Increase it." When the Congress decides that step one is over, then OMB comes along in step two and unilaterally says, "Ha, Ha, Ha. Congress may have said $250 but we're saying $50."

That becomes a pretty critical institutional issue. Who gives OMB the power, after Congress has acted to set an authorization level, to reduce that level. That is an area that I am very much interested in. I got into a battle on that one on the floor of the Senate on the housing guarantees, and we were able to resolve that on the floor. But this is an ongoing issue that is just beginning to be uncovered publicly, and I think is worth a great deal of public discussion.

This panel is not the right panel, I am afraid, to do that. I missed the Acting Administrator this morning. He would have been the right one to beat over the head on that. I want to know whether the SBA is going to fight, once it gets an authorization, to preserve that authorization; or whether it will simply, internally in the administration, abdicate its responsibility the way the administration and the executive branch seems to think it can run roughshod over legislative responsibilities to set these levels.

I guess, Mr. Chairman, I am using these few moments not to ask questions of the panel, as I should. I will read their testimony, and I am sorry I missed it. It really behooves us to get involved in this issue. We would be doing a service for the Congress, not just the small business community. With your leadership, we have already become involved in this area. I would hope we could increase that involvement.

I am going to offer an amendment to prohibit any agency of the Government from reducing its authorized level of loan guarantees, where there are qualified applicants—obviously that is always an assumption, and that is why I asked you if we have enough applicants for $250 million. This is an institutional question involving the executive and legislative power, and I would hope that this committee would continue to take the lead in urging and advocating that once the Congress has spoken, once we have gone through the whole give and take of the budget process of setting an authorization level, that then it is not permissible for the Executive to come along and unilaterally restrict a specifically authorized level of loan guarantee programs.

I would hope we could continue to be active in that effort. I know that we began it last year, but we have a long way to go. We can sit here and tear our hair out about these reductions, and resolve them or think we have resolved them, and then have the whole thing turn out to be meaningless if in phase two the OMB or the White House or elsewhere in the executive branch they can simply say, "We're going to make unilateral reductions." That is my short piece this morning.

Senator WEICKER. Thank you, Senator. I concur with you. You should not feel any regrets about not being here to come down on the head of the Acting Administrator. I think if one more Senator had come down on his head, it would have been impossible for him to leave the committee room under his own power. It is probably

good that he was saved for you for another day, which I am sure will happen.

Gentlemen, thank you very much. We must move to our last panel, but I very much appreciate your testimony.

[The prepared statements of Mr. Sower, Mr. Graves, and Mr. Rashed follow:]

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GROWTH CAPITAL FOR SMALLER BUSINESS
A NATIONAL ECONOMIC REVITALIZATION STRATEGY
SBA'S NEW 503 PROGRAM

Statement

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Senator Lowell Weicker, Jr., Chairman
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Washington, D.C.

February 23, 1982

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GROWTH CAPITAL FOR SMALLER BUSINESS

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GROWTH CAPITAL FOR SMALLER BUSINESS

A NATIONAL ECONOMIC REVITALIZATION STRATEGY

SBA'S NEW 503 PROGRAM

I. THE ISSUES

A. Introduction

Our topic today is SBA's new Section 503 Certified Development Company Program — an important new tool to help smaller businesses increase their capital investment and thereby make a dent in the federal budget deficit by both paying more taxes and creating jobs which reduce unemployment payments.

This presentation will cover "why" the 503 program was created and "why" it is important.

I wear two hats as I speak today — first as Washington Director of the National Development Council, a private, nonprofit organization sometimes known as "economic development investment bankers." Over the past four years, we have helped 75 local communities to organize and implement their economic development financing programs creating $2.0 billion of capital investment in 3,000 small and medium-sized businesses and creating over 130,000 permanent, private sector jobs.

We have revolutionized the local economic development financing business by incorprating rigorous private sector management techniques and a network of financially skilled loan packagers in the nation's major cities. We have helped to institute "hard" policies of providing long-term, fixed asset financing for growing, healthy businesses to create permanent jobs rather than the "soft" money-losing policies of providing stop-gap aids to failing, marginal firms or high-risk start-ups.

My second hat is as unpaid Incorporating President of NADCO — the National Association of Development Companies — a new professional trade association representing the 172 Section 503 Certified Development Companies in local communities across the country.

B. The Economy

1. Introduction

We all know the state of the economy — we are officially in a recession. The tax reductions are just starting and more spending cutbacks are coming. Nonetheless, the pressures of both inflation and interest rates continue. Officials are now talking about an annual federal deficit for Fiscal Year '87 of nearly $100 billion.

2. Overlooked Small Business — Britain

The March 22, 1981 issue of the Miami Herald reported on a study of Britain's economy by Professor Allen Meltzer of Carnegie Mellon University, and states, "The most disturbing of Meltzer's findings about Britain is the failure of Thatcher's tax cuts to produce a spurt of investment."[1]

I'm no great student of the English economy but I am not surprised, as the large percent of their economy consists of government owned monopolies or large corporations supported directly or indirectly by the national government that don't pay much taxes — thus would not be much affected by the change in the tax rate. It is as if we had nationalized and then subsidized W. T. Grants, Chrysler, Amtrak and every other major corporation that has had problems — plus a hundred more.

The October 3rd issue of the Economist had a section on the American economy entitled "Oh, For a Burst of Growth." It stated, "A dash of growth, of course, would work wonders for the President's arithmetic, by cutting outlays and increasing tax revenues."[2] The same issue had a long article about the dynamic growth of smaller business in the English economy in the past decade — despite the adverse economic conditions in that country.

Interestingly, that issue of Economist missed the point — like a trout fisherman who doesn't see the fish swimming at his feet. An important source of new growth and investment in both their economy and ours is smaller business. Even through aggregate economic statistics show a recession with high unemployment and declining industries such as automobiles and steel, many smaller business sectors are booming — particularly those in the newer technologies such as electronics, energy, medicine and computers. Smaller businesses are rapidly creating new jobs, developing new technologies and generating tax revenues in hard-pressed communities.

Thus, a logical policy conclusion would seem to be to aggressively stimulate the growth and investment of smaller businesses, i.e., support your winners instead of your losers. We ought to be aggressively helping expanding, successful smaller business. Unfortunately, smaller business has made it in rhetoric thus far, but not in terms of hard policy — certainly in England and perhaps in our own country.

3. Tax Cuts and Small Business

Tax cuts and tax credits help all businesses, as some of the small business groups have pointed out, they really don't stimulate as much capital formation for smaller businesses which are in lower tax brackets and are less capital intensive. Moreover, tax cuts do not help new businesses nor provide the steady infusion of new capital that is needed in all growing businesses — both large and small.

Tom Richmond, Washington Editor of Inc. magazine, stated in an October 1981 editorial entitled "Why Small Business Lost on the Tax Bill," "If...you take the position that a healthy economy, while necessary, is not

by itself sufficient to insure accelerated growth in a declining small business sector — then small business didn't fare very well."[3]

David Stockman is reputed to have said, "I've never believed that just cutting taxes alone will cause output and employment to expand."[4]

I disagree. I think the President is right — but that it is just a matter of time — although unfortunately, it may take quite a bit of time.

As evidence, I suggest we look at the venture capital industry. A recent Business Week article stated, "After a veritable drought in venture capital investing before the 1978 capital gains tax cut to 28% from 49%, a near flood of money is rapidly reshaping the field. This year, the pool of funds used to back new inventions, technologies and companies is swelling to $6 billion from $2.8 billion in 1977."[5]

In summary — tax cuts will spur investment — gradually not explosively. In the meantime we need to accelerate the capital formation process in the fast booming smaller business area with policies and programs that provide growth capital for smaller businesses — such as SBICs and Section 503 CDCs.

4. Need for Investment

We are all waiting for the "supply-side surge," the slow-in-coming increase in capital investment by the private sector that will generate empoyment, reduce unemployment payments and increase tax revenues — thus reducing the federal deficit and stimulating the nation's economic growth. However, we also need something more — we need more growth capital for smaller businesses — so that they can move now and lead the way out of this recession.

Growth capital is important in other countries as well — and it is more than just tax cuts. A recent British study on capital formation stated, "There is much evidence to indicate that the much envied economic performances, particularly in West Germany and Japan, are based primarily on the availability of long-term, low cost investment credit to their industries."[6]

The important issue, thus, is to find ways to stimulate more investment capital for the growing sectors of our economy — by different methods including tax cuts, reduction of regulations, lower interest rates and more growth capital, particularly for smaller businesses.

C. Importance of Small Business

1. Creation of Jobs

a. The role of small business in creating new jobs in the economy is increasingly realized. In 1979, David Birch of MIT wrote a report entitled "The Job Generation Process" emphasizing the importance of small business in creating new jobs. One conclusion was that "small firms (those with 20 or fewer

employees) generate 66% of all new jobs generated in the U.S."[7]

b. President Reagan, in his April 29, 1981 presentation to the Congress, stated, "Let us not overlook the fact that the small, independent business man or woman creates more than 80% of all new jobs and employs more than half our workforce."

c. George Gilder, one of the Administration's economic advisers, stated in a chapter entitled "The Entrepreneurial Future" in his book Wealth and Povery that "It is small and high technology businesses...that generate most of the employment in America....In addition, small firms provide more than 80% of the jobs for young blacks and other disadvantaged citizens."[8]

2. Technology and Innovation

Small businesses' contribution to innovation and technology development are also increasingly understood. The April 1980 report of the White House Commission on Small Business stated, "Small business has demonstrated incomparable innovative fertility. The National Science Foundation study disclosed that, for every R&D dollar, small companies produce four times more innovation than medium-sized companies and 24 more times innovation than large companies."[9]

They also say, "A study by the Office of Management and Budget shows that more than half the major technological advances of this century originated from individual inventors and small companies."[10]

II. GROWTH CAPITAL GAPS

A. Introduction

1. Definitions

All companies need growth capital — both equity and long-term debt, to finance their normal expansions. Large companies such as AT&T go to Wall Street regularly to sell stocks or bonds. When I was in business school, we learned theoretical formulas for determining whether it was time to raise either debt or equity.

Unfortunately, smaller companies do not have a choice — generally the decision is only of availability, not choice — as there are tremendous growth capital gaps for smaller businesses in our economy.

Moreover, the point is usually overlooked or misunderstood under the assumption that banks or the private sector will provide all the capital that a profitable business needs, or that highly publicized computer companies or "gene splicers," that are wooed by private venture capitalists, are typical of the financing stories of all small businesses.

A recent study by California's Department of Economic and Business Development stated, "A recurring concern...is the availability of capital to support the establishment and growth of dynamic small manufacturers."[11]

Furthermore, the January 1981 issue of Inc. magazine reported on a survey of 2,000 small businesses in which the "availability of long-term credit" was the third most important factor (out of 24) to small businesses in 1982.[12]

2. The Need

A growing small business needs long-term debt capital or equity capital for two primary needs:

a. Fixed Assets

Fixed assets, such as land and building, need to be financed by long-term financing, either as debt or equity. Short-term financing of 3-5 years for a new factory building is no more prudent than for a prospective home buyer.

b. Permanent Working Capital

Secondly, growing companies need permanent working capital in the business. A simple example makes the point. A growing company with annual sales of $1.2 million whose customers pay in 30 days needs $100,000 just to finance the receivables. If sales double to $2.4 million, then the company would need an extra $100,000 for expanded receivables — excluding additional capital needs for the cost of work in process. Some very "profitable" companies go bankrupt by growing too fast — due to this reason.

Tax cuts reduce the amount of money taken out of the business, but do not increase the new capital infusion into the business — which is the key need of a growing business.

B. Equity Capital

Growing smaller businesses usually start with equity investments from the founder/entrepreneur. They have difficulties obtaining equity capital for expansion. This section outlines the equity capital alternatives for smaller businesses ranging from informal risk capital from friends and neighbors to Wall Street investment bankers.

There really isn't much equity capital available to begin with. Mr. Reginald H. Jones, former Chairman and Chief Executive Officer of the General Electric Company, stated at the recent annual meeting of the American Council for Capital Formation, "In the decade of the 1960s, new equity provided only 1.5% of corporate cash sources. This grew to 5.6% in the first half of the 1970s but then fell sharply in the last half of the decade."[13] He predicted a figure of 3.4% during the '80s, most of which is for the nation's largest corporations — not growth capital for smaller businesses.

1. Informal Risk Capital

Most businesses start with money invested from the founder or his/her friends or associates. SBA's Office of Advocacy did a study of this source of capital which stated, "Informal investors are difficult to reach — geographically dispersed and tough to identify."[14] They also stated, "...the availability of essential risk capital (venture and equity capital to finance new and growing small firms declined steadily during the 1970 decade."[15]

2. Venture Capital

Venture capital is a phrase describing a variety of people and organizations including SBICs, private investors, corporations, etc. Venture capitalists are generally private sector investors looking for the "cream of the crop," the fast growing, most potentially profitable businesses. They do not finance the normal expansion needs of most smaller businesses. The September 1981 issue of Inc. magazine stated, "Organized venture capital will have little impact on the expansion capital needs of the vast majority of small businesses."[16]

In a section entitled "Expansion Capital: The Critical Issue," he stated, "Only a tiny fraction of the half million businesses started in the U.S. each year promise the kind of returns on invested money venture capitalists need."[17] In the same issue, Mr. Morton Collins, President of the National Venture Capitalists Association, states, "We are in the business of financing losses, not plant and equipment,"[18] i.e., venture capitalists are interested in fast growing start-ups and not moderate expansions needing plant and equipment.

David Brophy, Professor of Finance at the University of Michigan in Ann Arbor, Michigan, commented on Michigan's depressed economy and stated, "I compared Ann Arbor to Boston and Palo Alto because those are the two points of reference for technology-based industry. And as I visited there and talked with people, it appeared financing was the key element. Without local access to venture and growth money, the businesses just don't grow."[19] He cited the key difference between Michigan and Boston or Palo Alto respectively was that "Michigan's technology-based firms had to go out of the state to raise more of their venture capital."[20]

3. Investment Bankers

Investment bankers are the largest source of equity capital for large corporations, however they do not provide substantial equity capital for growing small businesses. An August 1981 study done by the SEC and SBA entitled "The Role of Regional Broker-Dealers in the Capital Formation Process: Underwriting, Market-Making and Securities Research Activities," pointed out that although the minimum initial public offering underwriting criteria of regional broker dealers was less than for national broker dealers, their standards still were too large for smaller businesses as their minimum dollar volume for an underwriting was $2.1 million, the minimum annual revenues for a client business was $4.4 million, the minimum net worth for a potenial business was $1.7 million, the minimum net profit was $600,000 and the minimum number of years incorporated was three years."[21]

The point is further made in a recent publication of the Donaldson, Lufkin and Jenrette Investment Banking concern where it describes its particular expertise in specific sectors including energy and emerging growth companies such as the computer, electronics or medical technology areas.[22]

4. Summary

Summarizing equity capital, although there are many players in equity and venture capital, most of them are chasing the cream of the crop and according to Inc. Magazine of September 1981, "The supply of expansion capital for small business has never been adequate in recent years and is less so today. The innovation and expansion capital gap will continue to be the critical problem for small business."[23]

C. Debt Capital

It is also difficult for most growing, profitable firms to obtain long-term debt capital for expansion.

1. Financial Institutions

None of the financial institutions are in the market for providing long-term debt capital for growth businesses.

a. Banks — All small businesses have bankers, yet bankers are short-term lenders — particularly in today's money market. Tax-exempt industrial revenue bonds, mostly bank loans in disguise, are helpful as they do reduce the interest rate.

b. Savings Institutions — Savings institutions were created to finance residential development, and in today's money market they are inactive.

c. Insurance Companies and Premium Funds — Insurance companies and pension funds are the primary source of long-term capital in the economy, however, they prefer larger projects — over $1 million.

Consequently, there is a long-term loan gap for smaller businesses in our economy.

2. First National Bank of Boston Study

The Council for Northeast Economic Action, an affiliate of the First National Bank of Boston, published a study in February 1981 entitled "An Empirical Analysis of Unmet Demands in Domestic Capital Markets in Five U.S. Regions."[24] Their survey was mailed to 30,000 business firms selected by five major banks, and the results confirm the growth capital gaps for smaller businesses. They concluded that there is a long-term credit gap for smaller businesses and that there may be as many as 50,000 viable smaller firms that have been unable to raise funds in the capital market.

3. Neighborhood Business Revitalization Program

The National Development Council's Neighborhood Business Revitalization program offers further evidence of the long-term debt capital for smaller businesses. In a four-year time period, the National Development Council was able to work in sixty cities and obtain long-term debt financing for 3,000 small and medium-sized businesses totaling $2.1 billion and creating over 130,000 private sector jobs. This figure really represents the tip of the iceberg rather than any saturation of the demand for long-term credit for viable businesses nationwide.

4. Small Business Investment Companies

Small Business Investment Companies (SBICs) are a tremendously important source of growth capital and include approximately 350 SBICs licensed by the SBA which in turn lend money to SBICs at preferred rates. SBICs have private investment from their owners and long-term debt from SBA. However, the report of the White House Commission on Small Business was concerned about the use of debt by SBICs and stated, "SBICs and minority enterprise SBICs in recent years have tended to relend their money to small companies at higher interest rates instead of investing in equity."[25]

5. Certified Development Companies

A newer program, designated specifically to provide long-term, subordinate debt for the fixed asset expansion needs of growing smaller businesses, is SBA's Section 503 Certified Development Company program. This program has been operative for approximately 10 months and has met tremendous demand for long-term debt capital by growing small businesses. In that time period, over 200 communities submitted applications to participate and 260 loans have been approved totaling approximately $40 million.

III. SUMMARY AND CONCLUSIONS

A. Summary

The growth capital needs of smaller businesses can be summarized by visualizing a pyramid in three tiers: Venture Capital, Risk Capital and Expansion Capital.

1. Venture Capital

The top layer is the cream of the crop of the venture capital business — very high risk, very few deals, very private sector and very high reward if you hit it right.

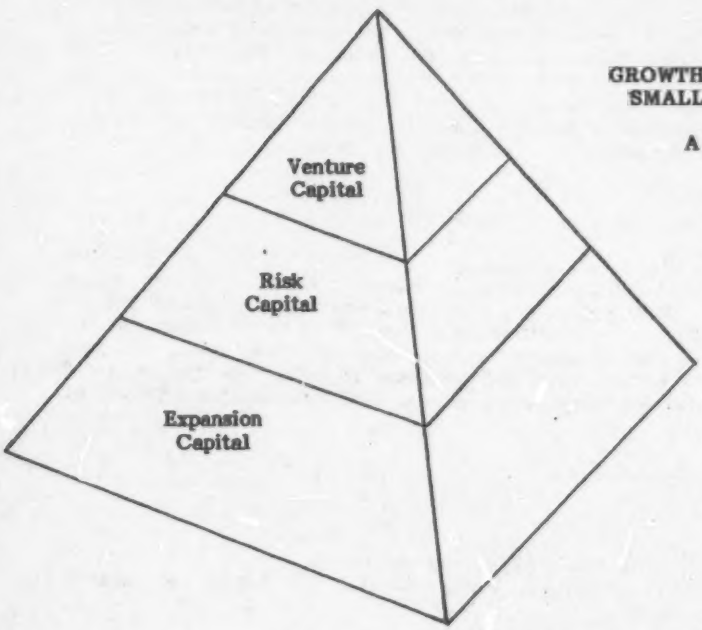
2. Risk Capital

The next "tier" of the pyramid might be called risk capital and includes both equity and debt investments by private investors for smaller businesses. Risk capital is predominantly private sector, although SBICs receive government guaranteed debentures. Investors in these businesses

do seek long-term growth — although not as risky perhaps as venture capital. The risk capital tier is larger than venture capital.

3. **Expansion Capital**

The third and bottom tier of the growth capital pyramid could be labeled "expansion capital," and is the area for the new SBA Section 503 program. CDCS, or Certified Development Companies, are public/private partnerships and are very important in the long-term creation of jobs in growing smaller businesses throughout the country. These long-term, fixed asset loans to expanding, profitable companies are not risky, and there isn't sufficient reward to invite venture or risk capital. This bottom tier of the pyramid is by far the largest.



GROWTH CAPITAL FOR SMALLER BUSINESS

A Pyramid

Tier	Risk	Reward	Volume of Business	Private or Public $
Venture Capital	Very High	Very High	Very High	Totally Private
Risk Capital	Moderate	Moderate	Moderate	Mostly Private
Expansion Capital	Low	Low	Very Many	Public/Private

B. Cost Effectiveness

The SBIC and CDC programs indirectly use long-term government debt, which, contrary to common knowledge is declining relative to the GNP. The October 1981 issue of the newsletter from the American Council for Capital Formation quotes Professor Benjamin J. Friedman, Harvard Professor of Economics, in a study completed by the National Bureau of Economic Research, "Except only for 1975-76 and 1980, the Federal government has reduced its debt ratio every year since 1953."[26]

Also, the February 1, 1982 issue of Forbes states, "Fears that Federal borrowing will crowd out private borrowing are greatly exaggerated."[27]

The use of long-term government debt to leverage private debt and create permanent, private sector employment in expanding, successful small and medium-sized businesses must stand the test of cost effectiveness. What are the real costs of job creation in CETA, public service job programs, welfare, crime, supplemental unemployment insurance, etc.?

The Neighborhood Business Revitalization demonstration program created 132,584 jobs in 2,943 small and medium-sized businesses resulting from financing of $2.1 billion of capital investment. This results in one job created for each $15,616 of investment of which $13,199 is private capital and $2,417 is from the government. Hence, one permanent job can be created with a cost of $2,417 — which gets repaid with interest.

This is far more cost effective than the other programs which require $10,000-20,000 per year for each job — each year!

C. Conclusion

The November 2nd editorial of Business Week stated, "The facts are making it distressingly but unmistakebly clear that the economy is not responding as hoped."[28] The supply side surge is slow in coming.

Our policy conclusion is as follows: All companies need capital investment to grow, to create jobs, to pay taxes and to increase the competitiveness and productivity of the American economy. Smaller businesses are a primary source of that growth and job creation but they are not the focus of policy — particularly regarding the availability of growth capital which, as outlined above, is not very available from the wide variety of sources of capital in the American economy.

Statistics from the SBIC, Section 503 CDC and Neighborhood Business Revitalization programs show that policies and programs to create jobs and stimulate the economy are far more cost effective than other employment programs. However, more attention and stronger policies and programs to provide growth capital for smaller businesses are needed. The same is true in Britain. A recent Economist article on the growth of high technology companies in Britain laments, "Many high tech companies have come to grief (or never got off the ground) through lack of finance."[29]

In a chapter entitled "The Imperatives of Growth," George Gilder summarizes, "Those smaller corporations with less access to loans, no access to equity markets...suffer more obviously (from inflation and excessive regulation)."[30]

His policy reommendation is: "If the United States diverts the proceeds of its inflation tax into the creative core of capitalist growth — the new research and industry of the future — both the problem of inflation and the problem of growth will disappear."[31]

Stronger policies and programs providing growth capital for smaller businesses, such as the 503 program, are the essence of that policy.

John Sower
Washington, D.C.

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3. Inc. Magazine, October 1981.

4. "The Education of David Stockman," William Greider, The Atlantic, Vol. 248, No. 6, December 1981, page 46.

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8. George Gilder, Wealth and Poverty, Basic Books, New York, 1981, page 83.

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11. "Financial Performance, Growth and Financing for Small Manufacturers," Office of Economic Policy, Planning and Research, California Department of Economic and Business Development, May 5, 1981, page 1.

12. Inc. Magazine, January 1982, page 32.

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14. "Informal Risk Capital in New England," William E. Wetzel, Jr., Whittemore School of Business and Economics, and Craig R. Seymour, Center for Industrial and Institutional Development, University of New Hampshire, Durham, New Hampshire, January 1981, page 62.

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16. Christopher A. Leach, "The Billion Dollar Gamble," Inc. Magazine, September 1981, page 58.

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18. Ibid., page 61.

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28. Business Week, "Editorials," Noember 2, 1981, page 156.

29. "Britain's Sunrise Strip," The Economist, January 30, 1982, page 73.

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ORAL TESTIMONY OF E.M. GRAVES

Mr. Chairman, my name is Eben M. Graves Jr. I am the president of E.M. Graves Investment Advisory Inc. a Connecticut based investment advisor to public and private retirement funds. I represent myself and the investment firm I started in 1976.

I am here to tell you that Reaganomics, or specifically, this administration's adopted policy of eliminating the federal loan guarantee programs is going to destroy the ability of a small and rural business to raise term capital. This administration is anti small and rural business. In absolute numbers, 90% of American business is small business. Small business creates 85% of the nations jobs.

What this administration should be doing, and what the Congress will be doing is to implement and adequately fund programs that will stem the tide of rapidly escalating unemployment. Detroit currently has a 20% jobless rate. The state of Indiana is running at 16.5% unemployment. The consulting economists that advise my firm are estimating that the national rate of unemployment will rise from 8.5% to 10% or higher in fiscal year 1982. These levels are close to the 1933 level of unemployment.

How can Congress help put the people back to work without creating the incredible ruinous deficits projected by the administration of - 109.1 fiscal 1982; 152.3 fiscal 1983, and, 162.0 billion in fiscal 1984. (O.M.B. Data)

There are two major federal loan guarantee programs - one currently in the Department of Agriculture called the Farmers Home Administration Business & Industry program, and the Small Business Administration Section 7A business loan program.

The Reagan Administration would like to forget about these programs because their success is an embarrassment to the Administration. "If the success of these programs was widely known in Congress, the Administration knows that it would have trouble cutting other federal programs." I can tell you gentlemen, that the last sentence is a direct quote from Mr. Richard Lyng, Under Secretary of Agriculture, spoken to me on the last day of the Transition Team's term in 1979. This is also the current feeling of Mr. David Stockman, of the Office of Management and Budget. The FmHA B & I program, and the SBA Section 7A program are the most cost effective loan programs in government today.

The SBA and the FmHA B & I programs are examples of how Congress and the Administration can work together in expanding, by billions of dollars, the federal loan guarantees to small and rural businesses. Remember, that all of these loans are made through local lending banks who can then sell the loans to pension funds at no significant cost to the government. This is not deficit spending. This is a free recycling of savings dollars into investment dollars, with the passive guarantee of the U.S. Government as the catalyst in the recycling equation.

Here are the FmHA Business and Industry loan statistics provided by the Department of Agriculture, and checked by my firm: $3,546,397,621 of loans were made from fiscal year 1977 through fiscal year 1981 to 3,551 rural businesses in 50 states, commonwealths, and

territories. This $3.5 billion in loans, made and administered by local banks and guaranteed for a 1% guarantee fee paid by the borrowers, created or saved 273,134 jobs at a cost per job of $33.30.

The total of guaranteed fees collected was $31,917,578. The percent of borrowers who defaulted was 1.16%. Expressed in dollars, this was $41,014,000. If you subtract the total dollar number of defaults - $41,014,000 from the total dollars collected in guaranteed fees - $31,917,578, you have a net deficit or real cost of this program of $9,096,422. Expressed as a percentage of the $3.5 billion in loans, the cost is 0.26%.

These figures are significantly better than fiscal year 1981 totals. The net loss rate has dropped from 0.41% to 0.26%. The cost per job has dropped from $55.36 to $33.30. The default rate has dropped from 1.21% to 1.16%, and the net loss has dropped from $14,125,423 to $9,096,422.

Remember that last year was a recession year and that the Department of Agriculture's Office of Inspector General made dire predictions of real B & I loan losses of 14% to 15% of the $3.5 billion.

Remember, also, that B & I personnel total now only 85 people all over the country - down from 135 total personnel, and that the program was drastically cut in F/Y 81 $751 million appropriation from $1.1 billion. The program now for F/Y 82 is currently authorized at $300 million. At a $300 million level, the secondary market will lose interest in purchasing this paper and the recycling of capital will end.

Gentlemen, this is the best running, cheapest federal loan program within the Department of Agriculture and, one of the three best in the nation. However, for reasons beyond my comprehension, the Administration wants the B & I program eliminated.

The SBA Section 7A loan program has guaranteed $22.4 billion in loans from 1953 through December 1981. A 1% guarantee fee is charged the banks making these loans. The default rate is 3.9% from 1953 to date. The number of jobs created was 112,200 and the cost per job was $2,375. I want to emphasize that Section # 7A SBA loans carry market interest rates determined by a secondary market bid to a small bank. The interest rates are not 2-3%, with the Government having to subsidize the difference. The real cost of this program is the difference between the guarantee fee collected and the real default rate.

The Reagan Administration has completely disregarded the very low default rate, low cost, high job-creation characteristics of these programs. Most importantly, the Administration has completely ignored the real fact of private sector capital being recycled from savings into investment in small and rural businesses at little or no cost to the taxpayer and with nearly zero impact on the federal credit budget.

Here is what the Administration has done in one year to two programs which, if expanded, could actually shrink budget deficits. The Administration has instituted a bureaucratic slow-down on loan

guaranteeing, which flies in the face of Congressional authorization. In the first quarter of F.Y. 1981, SBA guaranteed 7,578 Section #7A loans for a total of $988,000,000. In the first quarter of FY 82, SBA guaranteed only 2,803 loans for a total of $346,000,000, whereas 500,100,000 Section #7A loans were approved as of January 31, 1982 - but undisbursed.

The Farmers Home Administration currently has $1,000,000,000 worth of loans currently awaiting final approval. Remember, that this is the most cost effective, high job-creation program in government. The FmHA budget has been slashed from $1.1 billion to $300,000,000. The personnel charged with administering $3.5 billion in loans currently in institutional hands have been slashed from 135 people to 85 people. Eight states currently have no B & I chiefs.

This Administration, while blessing larger mergers of oil and chemical companies, has done everything possible to destroy the ability of small business, which is 90% of American business, to raise term capital.

I will now take questions.

STATEMENT OF EBEN M. GRAVES, JR., CHAIRMAN
OF E. M. GRAVES & CO. INVESTMENT ADVISORY, INC.

Mr. Chairman, my name is Eben M. Graves, Jr., I am chairman of E. M. Graves & Co. Investment Advisory, Inc., a Connecticut based SEC registered investment advisor to corporate pension funds. My company is believed to be the first pension fund manager to invest in federal loan guarantee securities originated through local lending banks, guaranteed by a federal agency that collects a 1% guarantee fee and sold to pension funds we manage through a secondary market. The interest rate on these federal loan guarantees is determined by the free market supply/demand mechanism. Fixed rate paper is pegged to the Government National Mortgage rate and variable rate paper is pegged to the New York prime rate of interest.

The overall role of federal loan guarantee programs in the capital markets is to provide a government guarantee on loans originated and priced in the private sector. By providing a government guarantee, local lenders(small banks and small insurance companies) can make longer term capital available to small and rural businesses. These federal loan guarantee programs largely provide through local lenders the only sources of term capital to small and rural businesses.

I illustrate with an example: Say John Doe has a small manufacturing plant in Oklahoma that needs to build a new warehouse and buy some new trucks. He goes to his local bank which is a small bank with a loan request for a 20 year mortgage on the proposed warehouse and 10 year loan on the trucks. The local banker says, "Well John, we really don't like to make 20 year mortgage loans or 10 year equipment loans. Couldn't you get along with a 1 year loan that

we might renew next year if your business is still good and your financial statements look alright?"

John Doe can't live with a short term bank loan. He has to have a long term loan matched to the life of the new capital assets he needs to purchase for his business which currently employs 20 people. If he gets the loan on the terms that he can repay he will employ 5 more people.

Doe looks rather glumly at the banker. Then the banker says, "We could make this loan under either the SBA or FmHA Business and Industry loan program. It will be an SBA loan if you don't need more than $500,000. However, your total loan request is for $1,200,000. Let me call FmHA and see if you would qualify." The call is made. It appears that Doe's business qualifies.

Doe is puzzled and asks the banker why he would lend long term debt capital under the FmHA B&I guaranteed loan program, when he wouldn't lend a dime conventionally without a federal loan guarantee.

"Well John," the banker answers, your loan will probably be guaranteed up to 90%. When the funds are disbursed to you I, the bank, can sell the guaranteed portion of your loan into the national secondary market and recoup 90% of the funds I lent you. This allows me to make a larger than ordinary loan to you. Remember, we are only a little country bank. Also, I can make a long term loan to you, one that matches your ability to repay. To get the government guarantee you have to satisfy their credit requirements which are as stringent as those imposed by our own credit committee. You will

also have to pay a 1 percent one time guarantee fee. This is paid direct to the FmHA. The interest rate I charge will be competitive with other market interest rates. The rate will be determined by competitive bids received from the secondary market sources. The rate you will pay will be a half to three quarters of a point higher than the market rate on a Government National Mortgage Security. The bank will keep one-half percent of the rate you pay on the guaranteed portion of the loan as a servicing fee. We will continue to collect interest and principal payments on your loan and pass through to the pension fund purchaser the balance of interest and principal monthly".

"If there was no secondary market for these FmHA and SBA loans, we could not lend you long term capital to expand your business. The secondary market is a free system that simply and efficiently allocates capital saved in the pension system back into investment in small and rural American business."

"The reason the secondary market works is that the government guarantees and charges for that guarantee on your loan. When your loan goes into the secondary market there are four beneficiaries:

"(1) You, the borrower, get term capital you normally could not get.

"(2) A small country bank like us, can make a big loan, a loan we normally could'nt make to you a valued local business.

"(3) The nations pension funds get a full, faith and credit obligation with an interest rate competitive with corporate bonds.

"(4) The American taxpayer doesn't have to pay a subsidiary for you get this loan. You, the borrower, paid the government

for the privilege of getting a federal loan guarantee. You paid 1% of the proceeds of the loan. If less than 1% of all borrowers go broke around the country, the U.S. Treasury makes money."

Borrower Doe says, "You mean that the government guarantee makes the secondary market possible?"

Banker: "Absolutely. The government guarantee makes your loan a safe investment, one of the safest high yielding investments a pension fund could purchase." Best of all, states the conservative banker, "you and I, the taxpayers, don't get hit with increased cost of the federal budget in our taxes."

"How many FmHA Business and Industry Loans are outstanding?", asks borrower Doe.

The banker replies, "There are currently 3,546,397,621 FmHA B&I guaranteed loans currently outstanding. All these loans were made by small rural banks in 50 states like us. Ninety-seven percent were sold into the secondary market. This was a God send in that we could not have made the loans otherwise. Of the $3.5 billion worth of loans made, 1.16% defaulted. However, when you subtract the $31,917,578 collected in guarantee fees from the default figure ($41,014,000), you get a net loss figure of $9,096,422. This is the real cost of the FmHA B&I program. . . The cost to you and me as taxpayers. It represents .26% of the total $3.5 billion in loans made.

"That doesn't sound like much money when you look at the really wasteful direct loan and subsidiary programs the government

sponsors", states John.

"It isn't any real money at all arrayed against the size of the overall federal budget. In fact, if the guaranteed fee was raised by FmHA to 1½%, the program would actually make money."

"If you look at the amount of new jobs created or saved, a very hard case can be made that the FmHA, B&I and SBA section 7A guarantee loans actually do make money. Every new person going into the work force pays taxes. Every person who has a job saved doesn't go on unemployment of welfare or need government assistance."

The Banker continues, "the $3.5 billion in FmHA B&I loans created or saved 273,134 jobs in rural America. The cost per job was $33.30. This was the lowest cost per job on any federal loan guarantee program", states the banker.

"Gee, I guess the new Republican Administration is using the FmHA B&I loans program as the example of supply side economics and how a well administered federal loan guarantee program priced and run through the private sector allocating capital to creditworthy concerns ...I guess the new administration is pushing programs like this."

"No John," replied the banker, "the Office of Management and Budget has tried to completely eliminate funding of the FmHA B&I program. If the current funding of $300,000,000 isn't restored to the $1 billion level, I'm afraid we can't make your loan. Instead of expanding your business and employing

more people, you may have to cut back and lay some people off. You might try SBA, their budget is only being cut $500 million or 18% in 1982. They may have some money left." (SBA & FmHA statistics are Exhibits A & B).

The borrower is silent. The banker resumes his rather dreary soliloquy, "The worst thing that these budget cuts will accomplish is to kill the secondary markets which depend on certain levels of supply of paper to fuel the pension funds' and savings institutions' purchasing interest. The secondary market, along with the passive government guarantee, is what really has been recycling savings capital into investment capital. It's really a shame. Instead of cutting these pure secondary market programs, the Congress and administration should have gradually increased them and eliminated the direct loan and subsidiary programs and used the interdepartment savings to increase FmHA B&I to the $4 billion budget level and leave SBA-Section 7A loans at the $4 billion level. No, John, I'm afraid that when they started cutting, they really didn't look too carefully at what they were cutting." Now that we are in the recession with unemployment at 9% and rising, we really need these federal loan guarantee programs that provide the only viable source of term capital to small and rural business. Small Business represents 90% of American business in absolute numbers, and employs 85% of the American people. The Reagan administration, has it seems, completely abandoned small business - eliminating the source of term capital.

BIOGRAPHICAL BACKGROUND ON EBEN M. GRAVES, JR.,
COMPILED FROM ROSTER OF NOTABLE CONNECTICUT
BUSINESS OWNERS AND WHO'S WHO IN AMERICA

Education: Mr. Graves graduated from Westminister School in 1959 and The University of Pennsylvania in 1963 with honors. He headed the student judiciary committee, the dean of men's committee on discipline and won five varsity letters in football and lacrosse. Mr. Graves earned a masters degree in Business Administration, started at the Wharton School of Finance and Commerce and finished at New York University Graduate School of Business.

Military: Mr. Graves was a Lieutenant in the U. S. Army Security Agency attached to the 101st Airborne Division from 1963-1965.

Business: Mr. Graves joined Drexel Burnham's Investment Banking Department in 1968 and rose to be vice president in fixed income sales in 1975.

Mr. Graves started and headed the Federal Financing Department of Merrill Lynch Pierce Fenner and Smith in 1975.

He founded his own Connecticut based investment management firm in 1976. He is an expert on the federal loan guarantee security, priced and sold through the secondary market.

Affiliations: President's Council on Small Business, Former Chairman of Federal Loan Guarantee Dealers Association, Connecticut Council on Small Business, Sustaining member of the Republican National Committee.

Articles and books: "The S.B.A. and FmHA Loan Programs" cc 1976. "A Totally Unique Approach to Fixed Income Management." "Beyond Immunization in Bond Management." cc 1981.

EXHIBIT A

B & I PROGRAM

CLOSED LOANS = $3,546,397,621

PENDING DISB. BUT OBLIG. IN PRIOR YEARS = $1,000,000,000

DEFAULTED CLOSED LOANS = 1.16% = $41,014,000

GUARANTEED FEES COLLECTED = $31,917,578

TOTAL BORROWERS - (CLOSED) = 3551

TOTAL DELINQUENT BORROWERS = 489

PERCENT OF DELINQUENT = 13.77%

DEFAULTED CLOSED LOANS: $41,014,000

LESS: GUARANTEED FEES : $31,917,578

NET - COST OF PROGRAM : $ 9,096,422

0.26% OF THE $3.5 BILLION DOLLARS OF LOANS

TOTAL JOBS CREATED & SAVED TO DATE: 273,134

COST PER JOB: $33.30

FISCAL 1981 - TOTAL EMPLOYEES 85 - DOWN FROM 135

$652,280,250 - LOANS ON $751,000,000 APPROPRIATION

DEFAULTS - 0 -

TOTAL JOBS CREATED & SAVED IN 1981

CREATED - 20,083

SAVED - 19,980

TOTAL - 40,062

EXHIBIT B

SBA #7A GUARANTEED LOAN PROGRAM

FY 81	22,288 loans	22,000 borrowers
FY 81	$2,805,000,000 - Dollar amount of loans	
FY 81	$ 22,700,000 - Guarantee Fee	
FY 81	$8,936,000,000 - Total Loans	
FY 81	$ 465,000,000 - Delinquencies	
FY 81	5.2% - Percentage of delinquencies of total $8,936,000,000 outstanding	
1953 (SBA inception) to FY 81	104,793 - Total other SBA loans outstanding (guaranteed - not direct loans - but other than #7A)	
1953-FY 81	5,250 - Total delinquencies	
1953-FY 81	258,363 - Total 7A loans	
1953-FY 81	$22,400,000,000 - Total 7A loans	
1953-FY 81	3.9% Total loss rates	
1953-FY 81	9.5% Worst case potential loss rate	

Per $25,000 of loan amount, 1 job is created at a cost of $2,375 per job

112,200 jobs created (e.g., $22.4 billion, divided by 25,000)

Statistics to show that Administration is against small business - even when jobs are created at a period of high unemployment at a minimal cost.

First Quarter FY 81	7,578 loans, $988,000,000 (7A Loans)
First Quarter FY 82	2,803 loans, $346,000,000 (7A Loans)
January 31, 1982	$500,100,000 #7A loans approved but undisbursed.

NEW HAVEN COMMUNITY INVESTMENT CORPORATION

157 Church Street
New Haven, Connecticut 06510

TESTIMONY OF
HAAZIM RASHED, SMALL BUSINESS SPECIALIST
U.S. SENATE SMALL BUSINESS COMMITTEE
WASHINGTON, D.C.
FEBRUARY 23, 1982

My name is Haazim Rashed. I am the Small Business Specialist for the City of New Haven assigned as staff to the New Haven Community Investment Corporation, (NHCIC) an SBA Certified Development Company. I am representing Mr. Ronald C. Kysiak, the Executive Director of NHCIC and President of the National Council for Urban Economic Development. Mr. Kysiak is also the Director of the Office of Economic Development for the City of New Haven. I am also representing Mr. Joseph DiSesa, President of NHCIC.

On behalf of the City of New Haven and New Haven Community Investment Corporation we would like to thank Senator Weicker for his assistance and counsel to us. Mayor DiLieto asked me to convey his special thanks for the encouragement given to the City's development efforts by Senator Weicker at a meeting last week. In addition, we would like to thank Congressman Lawrence DeNardis who, along with Senator Weicker, was instrumental in guiding us through the SBA 503 certification process. I would add that through their efforts we were the first Certified Development Corporation in Connecticut and have three approved SBA 503 loans as of today.

I work primarily with small and medium-sized businesses in the City of New Haven. The City of New Haven had an

unemployment rate of 7.7% in December, 1981. Many of the major employers of the past in New Haven, like Federal Paperboard, Seamco and U.S. Steel, have closed resulting in reduced employment opportunities. The loss of major industrial concerns that provided employment for unskilled and semi-skilled workers has adversely affected employment in New Haven. Total jobs in New Haven have decreased from 93,000 to 87,000 since 1967, a loss of 6,000. These job losses have been primarily a result of the out-migration of major employers. The growth of small and medium-sized businesses in New Haven has mitigated, to some extent, the loss of employment experienced by New Haven.

A major factor encouraging the growth of smaller businesses in New Haven has been the SBA Title V lending programs, i.e. SBA 502 and now SBA 503. Through our participation in SBA 502 and now SBA 503 lending we have been able to assist in the creation of approximately 500 jobs and generate approximately $4 million in financing. Of the $4 million in financing generated, $2.5 million was from private lending with the remaining $1.5 million being split between SBA, Equity participation and NHCIC. Direct loans under SBA 502 totaled $790,000, SBA guaranteed debentures authorized under SBA 503 total $310,000 as of this date. We are processing loans that will total $5 million, with SBA guaranteed debentures of $2 million.

This total of direct and indirect Federal financial assistance means that each job created cost $2,200 in terms of Federal financial commitment. This low cost job creation, in Federal terms, speaks highly of the SBA 503 program. Since all monies are to be repaid to the government note holders by borrowers, SBA 503 is basically a very low cost program. In a time where the issue of return on government expenditures is increasing in importance, the SBA 503 loan program, more than any other, has a higher impact on job creation, at a lower cost, than any other.

Although SBA 503 is a low cost program, in terms of direct Federal financial commitment, it has a tremendous impact in encouraging private lending. We have commitments from every commercial bank and at least one thrift in New Haven to participate in SBA 503 lending. The banks financial commitment to our programs in New Haven exceed $40 million. One local banker was quoted as saying, "I'll do as many SBA 503 loans as I can, I think they are great for the bank and the business".

The great interest in SBA 503 on the part of banks makes it a strong possibility for many New Haven businesses. We are now contacted by banks who have clients that they would like to participate in the SBA 503 loan program. The burgeoning interest in SBA 503 indicates that there will be

a growing demand for SBA 503 loans. The proposed reduction in SBA 503 lending can adversely impact our program in New Haven by reducing the amounts available to the country as a whole and thus New Haven.

The reduction in the size of SBA 503 will reduce potential lending to New Haven based businesses. As perviously indicated, SBA 503 lending creates employment at a lower cost than other Federal lending programs. A reduction in SBA 503 will therefore result in a reduction in employment potential in New Haven. We would like to strongly recommend that the budget for SBA 503 lending be maintained at the previously approved level of $850 million.

As a representative of NHCIC, I would like to take this opportunity on behalf of the corporation to thank Senator Weicker and the other members of this Committee for the opportunity to address them on this matter.

Dollar Commitments

	Direct	SBA Guaranteed
American National Bank	$ 200,000	$ 2,000,000
Colonial Bank	1,200,000	12,000,000
Connecticut Bank & Trust	1,000,000	10,000,000
First Bank	200,000	2,000,000
Hartford National	1,000,000	10,000,000
Union Trust	1,000,000	10,000,000
	$4,600,000	$46,000,000
*First Federal Savings and Loan	$1,000,000	$ 2,000,000
Total Dollar	$5,600,000	$48,000,000
Bank of New Haven	50000	500,000
	$5,650,000	$48,500,000

*First Federal cannot in most cases use 90% SBA Guaranteed Loan Program, but it can participate in the SBA 503 loan program which has 2:1 leveraging.

Senator WEICKER. The last witness will be Mr. Walter B. Stults, president, National Association of Small Business Investment Companies; and Mr. Patrick Owen Burns, board of directors, American Association of Minority Small Business Investment Companies.

Gentlemen, your remarks in their entirety will be included in the record at the conclusion of your oral presentation. Please proceed now, in whatever fashion you deem appropriate.

STATEMENT OF WALTER B. STULTS, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES, ACCOMPANIED BY PATRICK OWEN BURNS, BOARD OF DIRECTORS, AMERICAN ASSOCIATION OF MINORITY SMALL BUSINESS INVESTMENT COMPANIES

Mr. STULTS. Thank you, Mr. Chairman.

NASBIC represents the overwhelming majority of all the SBIC's, both the regular kind and the MESBIC's. Since Patrick is here to cover the MESBIC programs, I will speak specifically to the 301(c) licensees.

Both of us can say that the SBIC program is a private sector undertaking. We make the decisions. We render the management assistance. We bear all the risk when one of our investments goes sour. The true genius of the SBIC program comes from its partnership with the small business owner. We can make a profit only if the small business prospers.

Since 1959, SBIC's provided over $4 billion to some 60,000 small business concerns. Last calendar year, we disbursed one-third of a billion dollars, the highest ever. In January of 1982, SBIC's invested $45 million, an all-time record 60 percent above January of 1981. So, despite the current pie in the economic skies, hundreds of SBIC's and thousands of small business owners are clearly bullish on the future. Both the suppliers of venture capital and the entrepreneurs who utilize it are placing their bets on the ability of innovative well-managed small firms to grow and be profitable.

We already testified before this committee about a study that we had commissioned by Arthur D. Little, Inc., which indicated that small businesses which received SBIC financing grew 10 times as fast as the average small business, in terms of employment, growth, profits, taxes, and net worth.

Deloitte, Haskins & Sells, an international accounting firm, last year demonstrated that the SBIC program had a very high cost/benefit study. In 1979 the Federal Government spent $4 million on the program and received $440 million in increased taxes from SBIC's, their portfolio companies, and their employees. I submit that even the tightest fisted scrooge would wring his hands in glee over a 110:1 cost/benefit ratio. More recently, Deloitte, Haskins & Sells has reported that as SBIC's create permanent jobs, the cost to the Federal Government is a maximum of $270.

I trust I have been able to convey to you my enthusiasm for this program which is carrying out a mandate given it by Congress. But our survival is in serious jeopardy as the result of President Reagan's budget proposals for fiscal 1983. That budget calls for authorized loans to SBIC's of only $125 million in fiscal 1983, 22 per-

cent from the $160 million authorized for fiscal 1981 and 1982, both of which incidentally are insufficient to meet the current demand.

Compounding the problem is the fact that $155 million of SBIC financing is maturing and must be repaid out of that fiscal 1983 authorization, in the way that Congress and the Federal Government use their system of accounts. Clearly, SBA will not be able to refinance some $30 million of maturing loans. There will be a net drop in the industry's assets of $30 million. There will be no new dollars. We estimate that SBIC's could effectively utilize at least $200 million in new leverage, both in the current fiscal year and in fiscal 1983. SBA will not be able to do that for us, giving us only $100 million in new money this year and nothing next year.

Obviously, the biggest loser in all this will be the entrepreneur and the owner/manager who requires SBIC dollars to start a new business or expand an existing firm. I assure this committee that NASBIC takes no pleasure in making this plea for additional funding in today's budgetary environment.

If you recall, last year NASBIC supported the President's cuts. It felt that with the short period of time that it had to review the fiscal 1982 budget, an across-the-board, a quantitative and not a qualitative, system of cuts, was probably the only way that it could do business. This year, it should have had time to look at all of these programs, and we feel that the cuts have been made across the board, not recognizing the value of different programs.

I have one additional note before I close. All of us are aware of the explosive growth of Federal credit programs. But I will bet that the dollar amount going to small businesses from all these programs has grown very little in the past 10 or 12 years, probably not enough to remain level in constant dollars. I know for a fact that SBIC's received $80 million in new leverage 10 years ago, back in 1972 and 1973. The SBIC program represents a unique kind of targeted economic initiative. It helps small business, creates jobs, stimulates private investments, develops new technologies, and generates added tax revenues. No other Federal program is set up to help venture capital. No other Federal program produces these results.

Mr. Chairman, the officers and members of NASBIC make this urgent appeal to your committee. Please take the leadership in expanding the authorization for SBA's guaranteed loans to SBIC's in fiscal 1983. As you know, this will require both an amendment to the current authorization act, which comes under your direct jurisdiction, and an increased authorization in the appropriation bill covering SBA for fiscal 1983.

Thank you.

Senator WEICKER. Thank you very much, Walter.

Mr. Burns?

Mr. BURNS. Thank you, Mr. Chairman.

I am Patrick Burns, president of Minority Equity Capital Company, Inc., a New York based MESBIC, and a member of the board of directors and chairman of the legislative committee of the American Association of MESBIC's on whose behalf I am appearing this morning. I would also say that we happen to be an active and long-term member of NASBIC, and I would like to join both in spirit and in content with Walter's earlier comments.

I have prepared and submitted a statement which I will not go through, but I would like to break my verbal comments into two points. One is directly relevant to the MESBIC industry itself, and the other is to comment very briefly on the SBIC guaranteed loan and direct loan programs and the proposed appropriations for them.

The MESBIC industry in this time frame finds itself in a somewhat anomalous situation compared to last year. Last year, we had our budget appropriations completely eliminated, and it was through the work of your committee and your leadership that we were able to retrieve half of our partnership, the public half of the private/public-sector partnership that is integral to the proper functioning of the MESBIC industry.

This year, events have transpired—again, I think, through the leadership of this committee. The awareness of the impact of the MESBIC industry on behalf of minority entrepreneurs across the country, the role that the MESBIC with its high-risk, equity-oriented financing is able to play both in job creation, job expansion, and capital formation. In my statement, I have given some idea of the kind of multiple and leverage impact that the Federal dollars have generated through partnership with the private sector.

We believe that the administration, with its budget submission for the MESBIC industry this year, has come to realize the crucial part that long-term venture capital oriented financing plays in the growth of small minority owned businesses. I would say as a side point that this need for long-term venture capital is absolutely identical, be it for a small minority business or a small nonminority business. It is distressing to us to see the administration's recommendations with regard to the SBIC leverage features and the willingness of the administration to continue to have the Government play its role as a partner in a partnership program that has proven so beneficial.

We believe that the administration's proposal for $41 million of leverage accessibility to the MESBIC industry is appropriate. We think that we should demonstrate, as I said, that we can utilize it effectively and efficiently. So that is the positive side of our appearance.

The negative side is that a number of the comments this morning reflect what we in the MESBIC industry feel is, if not conscious, certainly being acted-upon bias against small business. One of the early papers that I saw was a rough draft of the current administration's transition team that stated the philosophy that was, to us, awesome in its naivete: That was that the small business community should be freed of any burdens of restriction and any "burdens of governmental assistance," and small business and big business should be turned loose in the competitive marketplace, a battle which I have found to be very brief and with a fairly predictable outcome.

I think the administration perhaps, in its budget recommendations, is acting out this scenario. I think we have already commented on the SBIC program and the problems it will have, particularly in rolling over outstanding leverage, and the failure of the administration to play its part in a partnership agreement. But I think even more devastating, at least to our clients actual and potential,

are the gradual reduction of the guaranteed loan program, as well as to a lesser extent the direct loan program.

If I may speak very briefly about the minority business community, access to capital just is not there. In the kinds of normal "private-sector" raves that everybody is so bravely talking about, the starting entrepreneur in the minority business community does not have family or friends with extra private capital. It does not have access to bank capital in anything resembling routine ways, and the only way that most of our clients, even with our long-term venture-oriented investments, have been able to develop financing for fairly routine kinds of business transations, with reasonable degrees of collateral available, has been through the guaranteed loan program. I think any reduction in that program is absolutely counterproductive. It will have a negative economic impact.

I see Walter has an article that I have also Xeroxed, talking about who creates jobs. It is a truism that jobs are created by small, growing businesses. I think it is a second truism that higher risks have to be shared, both by the private sector, which has more than played its part through its investments in the MESBIC industry, but the Government partner has to pull its share as well. That is both in the leverage financing and in facing the hard facts of the need to open credit doors for small business in general and for minority small business in particular through guarateed loan programs.

Thank you.

Senator WEICKER. Gentlemen, thank you very much. I appreciate your comments. I realize that what you state here is a change in position. I just think there comes a point when we all have to stop wishing and come to grips with reality. As I said, that reality for many of your people that you represent is pretty tough right now.

Mr. BURNS. It is devastating, Senator. My days are spent almost predominantly in trying to hand-hold with businesses that are in extremis, that started out with good prospects and have been absolutely clobbered by a one-two punch of soaring interest rates and a squeeze in an access to credit. It is grim.

[The prepared statements of Mr. Stults and Mr. Burns follow:]

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*EXECUTIVE COMMITTEE

STATEMENT OF

WALTER B. STULTS

Before the

SENATE SMALL BUSINESS COMMITTEE

February 23, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

Thank you for inviting me to appear today. I am Walter Stults, President of the National Association of Small Business Investment Companies, an organization which represents the overwhelming majority of all small business investment companies (SBICs) and minority enterprise SBICs (MESBICs). Both SBICs and MESBICs are privately-organized, privately-capitalized, and privately-managed companies which provide equity capital and long-term loans to new and growing small business concerns. SBICs are licensed by the Small Business Administration under the Small Business Investment Act of 1958 and, in return for operating under SBA regulations, are authorized to borrow from the Federal Government. We pay the full cost of money to the Treasury plus a premium for these borrowed funds.

General Observations on Reaganomics

In common with most small business owners, NASBIC members have generally supported the basic features of the Administration's economic recovery program. We have endorsed the major thrusts of this policy: (1) tax reductions, (2) decreases in Federal outlays, (3) a steady monetary policy, and (4) a lessened impact of regulations on the private sector.

Furthermore, we heartily applaud actions which provide incentives for savings and investment. For too long, Federal tax policies have encouraged consumption rather than savings. Our bias is clear: we are investors, so we endorse policies which promote investment. But I do not apologize for what may seem to be a self-centered approach, because I know that the small business community requires affordable dollars more than any other commodity. An expanded pool of savings and investments will eventually mean that both loans and venture capital will be more readily available and at lower cost.

In addition, of course, small businesses should be the primary beneficiaries of lowered regulatory burdens, of policies which reduce inflation and interest rates, and of tax laws which augment cash flows and retention of earnings.

On the other hand, the real world in February 1982 does not reflect the high hopes of mid-1981. Inflation is down, but so is business activity. Interest rates are somewhat lower, but many feel that drop is temporary and the cost of money will climb to record levels as soon as the recession shows signs of abating.

It is timely, then, for your Committee to initiate this exploration of the status of small business. We hope that our comments will contribute to your study by shedding light on several specific segments of your inquiry.

P.L. 96-302 and the SBIC Program

Although the first report of the President under the Small Business Economic Policy Act of 1980 is not yet available, we believe it will mark a most significant advance in analyzing the role of independent business in the nation's economy. We are certain that the information and the statistics contained in the report will provide two important bench-marks: (1) the state of small business at the beginning of 1982, and (2) a review of Federal policies which have a substantial impact, either negative or positive, on small business.

Subsequent reports should demonstrate changes from this initial survey, so that Congress and the President will have a report card on the vigor of the independent sector of the economy and Government's efforts to foster its growth.

The 1980 Act itself provides rather specific yardsticks for measuring the value of Federal activities. Included among these criteria are such factors as: competitive climate, adequate capital, support of entrepreneurship, and opportunities for birth and growth of small enterprises.

We believe that the SBIC program epitomizes the pursuit of all these goals. Its primary purpose is the provision of venture capital and management assistance for new and growing businesses. The SBIC program is 100% a private sector undertaking. All decisions are made and all assistance is rendered by non-government people. All losses in this potentially risky industry are borne 100% by the SBIC until all of its capital is exhausted. Finally, the true genius of the SBIC program comes from its partnership with small business owners. I say that because an SBIC can make a profit from its investment only if the small business itself prospers and grows. Since our disbursements are made in the form of purchases of equity or subordinated loans, we cannot look to the liquidation of collateral to make us whole if the business fails.

Performance Record of the SBIC Industry

Up to this point, my statement has covered both segments of the SBIC industry, both 301(c) and 301(d) licensees. From now on, the statistics I shall give refer only to the 301(c) SBICs. I am certain the representative of the American Association of MESBICs will forcefully communicate the concerns which are peculiar to that part of our industry.

The first SBICs were licensed in March 1959. In the intervening 23 years, SBICs have provided over $4-billion in venture capital to some 60,000 small business concerns.

On December 31, 1981, there were 362 active SBICs with assets of more than $1.5 billion, almost equally divided between private capital and SBA-provided loans (or leverage).

These bare numbers are rather impressive for a relatively young industry, but more important is the fact that the industry is growing and investing more dollars today than ever before. In calendar 1981, SBICs put out $333-million -- up 12% from 1980, the busiest previous year. And in January 1982, SBICs invested $45-million, an all-time monthly record -- more than 60% above the January 1981 level.

So -- despite the current cloudy economic skies, hundreds of SBICs and tens of thousands of small business owners are clearly bullish on the long-term future. Both the suppliers of venture capital and the entrepreneurs who utilize it are placing their bets on the ability of innovative, well-managed small firms to grow and be profitable.

Two years ago, NASBIC commissioned a study of the economic impact of SBIC financing on small businesses. We have already shared with your Committee the results of that analysis, which was conducted by the international accounting firm of Deloitte, Haskins & Sells and the economic consulting firm of Arthur D. Little, Inc. In sum, the study demonstrated that our portfolio companies grew about ten times as fast as average small businesses in terms of profits, sales, employment growth, and tax payments.

Last year, Deloitte, Haskins & Sells followed up the 1980 study with two others: one computed the direct costs and the direct benefits of the SBIC program to the Federal Government; the other calculated the Government's cost of creating a job through the SBIC program. Both those studies came up with figures which prove the program's value to the national economy.

Let's take the cost-benefit study first: Deloitte, Haskins & Sells found that the Federal Government spent $4-million on the SBIC program in 1979: half was the cost of administering the program; the other $2-million was SBA's losses on its loans to SBICs. In return for that $4-million, however, the Federal Government received a total of $440-million from increased taxes paid by SBICs, their portfolio companies, and their employees.

I submit that even the most penny-pinching Scrooge would find a 110 to 1 benefit-cost ratio an attractive investment.

The second phase of Deloitte, Haskins & Sells' 1981 study analyzed the cost of creating a job through the SBIC program. The cost to the Federal Government: $270!! And these are permanent jobs in private businesses. I am aware of no other enterprise where the Federal Government receives an equivalent bang for the buck.

Incidentally, I would like to refer briefly at this point to an article by David L. Birch in the Fall 1981 issue of The Public Interest. Professor Birch found that two-thirds

of all new jobs between 1969 and 1976 were created by firms with 20 or fewer employees; and 80% of all such jobs were created by firms less than four years old. SBA has compiled data on SBIC-assisted firms in 1981 and found that 67% of SBIC dollars went to firms four years old or younger and 64% of the firms assisted had fewer than 20 employees. It's evident, then, that SBIC dollars are going overwhelmingly to those firms which create the most jobs. If job creation is a goal of this Congress and the Reagan Administration, the SBIC industry should certainly be encouraged. Mr. Chairman, I am submitting a copy of Professor Birch's article for your record at this point in my remarks.

To sum up: we have found, first, that small businesses have profited greatly from their use of SBIC dollars and management counseling; and, second, that the Federal Government has also made a tremendous return on its investment in the SBIC program. Our third conclusion deals with the vitality of the SBIC industry itself. I have already mentioned that SBICs put out more dollars in calendar 1981 than in any previous year and that January 1982 set an all-time record level for SBIC investments. I should also mention that an increasing rate of new SBICs, with increased levels of private capital, have been licensed during the past three years, with more now in the pipeline. Furthermore, there is more private capital in the program now than ever before -- almost $750-million, and that is twice as much as the industry had six years ago.

The Fiscal 1983 Budget and SBICs

I trust that I have been able to communicate to you my enthusiasm for the industry I represent. SBICs have successfully carried out the mandate given them by the SBIC Act of 1958 and the industry has been growing and investing more dollars each year.

But I am afraid that I must report that the survival of the SBIC program is in serious jeopardy today as a result of President Reagan's budget proposals for fiscal 1983. As you know, the budget calls for an authorization of only $125-million for guaranteed loans to SBICs next year. That is a drastic cut from the $160-million authorization in fiscal 1981 and contained in the continuing resolution for fiscal 1982.

Because of the industry's high activity level and substantial growth SBA was not able to meet all the requests for leverage from SBICs in fiscal 1981, and we estimate there will be a very serious shortfall in the current fiscal year. And fiscal 1983 will be an absolute disaster!!

During fiscal 1982, between $50-million and $60-million of present SBIC leverage will mature and I expect that the SBICs holding those loans from SBA will ask the agency to refinance them, because the SBICs are fully invested and do not have liquid dollars to repay the leverage. In fact then, the 1982 authorization of $160-million really means that SBICs can expect only $100-million in new leverage to augment their capacity to make further investments in small business.

In fiscal 1983, about $155-million of SBIC leverage will mature. Again we would expect that most of that is held by active licensees that do not have liquid funds -- all their dollars are out working in small buisness. The budget sets the maximum authorization at $125-million. Unless it is increased, SBA will not be able to roll over some $30-million in maturing leverage. If the SBICs involved are illiquid, the result will be defaults on repayments, leading to bankruptcy and liquidation.

Our study of the industry indicates that SBICs could effectively utilize at least $200-million in new leverage in both fiscal 1982 and 1983. SBA will be able to lend us only $100-million in added leverage this year and nothing at all in fiscal 1983.

Obviously, the biggest loser will be the entrepreneur and the owner-manager who requires SBIC dollars to start a new business or expand an existing firm. In addition, however, those who have invested in SBICs will also be seriously harmed, because they have counted on the availability of leverage to make their SBICs profitable.

I assure the Committee that NASBIC takes no pleasure in making this plea for additional funding in today's budgetary environment. We fully recognize your desire to restrict direct and indirect Federal spending, but we see no alternative at this time to leverage obtained through the SBA guarantee. Since SBICs invest long, they must borrow long -- or face the liquidity and cost squeeze which today threatens the existence of other financial institutions. Over the 23-year life of the program,

SBICs have found no private sources of long-term, fixed-rate loans. Our Association has explored a number of possibilities, but has found none of them viable.

Before closing, let me add one other thought. All of us are aware of the explosive growth of Federal credit programs; SBIC leverage is one tiny part of that picture. We know the dollars involved in these credit programs have been increasing rapidly, and I suppose that the portion of these programs focused on business generally has also grown substantially. On the other hand, I have the strong feeling that the dollar amount going to small business has risen relatively little over the past ten or twelve years -- probably not enough to remain level in constant dollars. I do know for a fact that SBICs received almost $80-million in new leverage back in 1972 and 1973, and we're scheduled to receive very little more than that in fiscal 1982 -- and none at all in fiscal 1983.

The SBIC program represents a unique kind of targeted economic initiative. It helps small business, creates jobs, stimulates private investment, develops new technologies and generates added tax revenues. We know of no other Federal credit program which produces these results.

Mr. Chairman, the officers and members of NASBIC make this urgent appeal to your Committee: please take the leadership in expanding the authorization for SBA's guaranteed loans to SBICs in fiscal 1983. This will require both an amendment to the current authorization act (legislation which comes under your jurisdiction) and an increased authorization in the appropriation bill covering SBA for fiscal 1983.

Thank you.

Deloitte
Haskins + Sells

USA

Cost-Benefit Study of the Small Business Investment Company Program

Performed for the National Association of Small Business Investment Companies

Summary and Conclusions

The Small Business Investment Act was created by Congress in 1958 to establish a program to provide equity and investment capital to small and medium-size companies. The Small Business Investment Company ("SBIC") program has provided financing to over 40,000 companies since its establishment. A previous study by Deloitte Haskins & Sells and Arthur D. Little, Inc. indicated the phenomenal growth of these SBIC-financed companies ("portfolio companies") and their contributions to the national economic and employment goals. As this study demonstrated, companies receiving SBIC funds have created growth in employment, sales and assets ten times greater than that of other small firms. The average growth rate of Federal tax payments of SBIC portfolio companies is over five times that of other small firms.

The successful results of the SBIC program are apparent; however, the cost of government programs to the taxpayer has become a topic of increasing concern. Remarkably, the Small Business Investment Company program does not cost the taxpayer because Federal tax revenues resulting from the program substantially exceed the program cost. This conclusion is based upon a study we conducted of SBICs and their portfolio companies covering the 1979 fiscal year.

To measure the benefits to the government of the SBIC program, "benefits" were defined as taxes paid by the following entities to the Federal government attributable to the SBIC program:

- Small Business Investment Companies
- portfolio companies, and
- employees of SBIC portfolio companies

This resulted in annual tax revenues to the Federal government from the program as follows:

	Millions
SBICs	$ 7.7
Portfolio companies	251.2
Employees of portfolio companies	182.4
Total	$441.3

The annual cost to the Federal government of the SBIC program includes the cost of administering the program and the loan losses experienced by the government as follows:

	Millions
Administrative costs	$ 2.1
Loan losses	1.9
Total	$ 4.0

Thus, SBIC program costs of $4 million for 1979 generated tax revenues received by the Federal government of over $440 million, a direct return to the Federal government of $110 for each dollar spent.

The results of this study demonstrate that the SBIC program has benefited both the Federal government and the private sector at no cost to the taxpayer.

Study Scope and Details

The purpose of our study was to evaluate the costs and benefits to the Federal government of the SBIC program. Deloitte Haskins & Sells had previously surveyed all portfolio companies as part of a joint study with Arthur D. Little, Inc. of the economic impact of the SBIC program. We used this survey data and information drawn from government documents to determine the various costs and benefits covered by this study. The data compiled did not include Section 301(d) SBICs (Minority Enterprise SBICs).

The calculations of costs and benefits and the underlying assumptions are explained as follows.

Taxes Paid by SBICs

The SBIC Digest Annual Financing Summary (May 1980) covering the 1979 fiscal year showed total Federal taxes paid by SBICs amounted to $14.3 million. A ratio of capital provided by the Small Business Administration ("SBA") to total capital of the SBICs was calculated to derive a government leverage factor of 54%. This factor was then applied to the $14.3 million to determine that taxes of $7.7 million were attributable to government financing.

The use of this leverage factor was based on the assumption that private capital would have been invested elsewhere and would have generated tax liabilities, but that leverage provided by the government and the resultant taxes could be specifically attributed to the SBIC program.

Taxes Paid by Portfolio Companies

Companies responding to our 1979 survey indicated taxes paid in the most recent fiscal year. To measure the portion of taxes attributable to SBIC financing, a factor based on their total assets and SBIC financing was developed.

For each portfolio company, total SBIC financing and total assets prior to that financing were used to determine the percentage of assets financed using SBIC capital. The assumption was made that the SBIC financing was used to acquire additional assets rather than to retire existing debt; this seems reasonable in light of the growth nature of most portfolio companies. Total assets financed through SBIC funds as a percentage of total assets was applied to each portfolio company's most recent annual tax liability to determine taxes paid attributable to SBIC financing. Use of this method is based upon the assumption that assets generate profits and, consequently, income taxes.

Since this calculation of taxes attributable to SBIC financing could only be performed for companies responding to the survey, an extrapolation was made to the entire population of SBIC portfolio companies. The respondents paid taxes of $45.3 million which were attributable to SBIC financing. The extrapolation of these results to the entire SBIC population amounted to $251.2 million.

Taxes Paid by Employees of Portfolio Companies

Companies responding to the survey also indicated the number of employees in the year prior to SBIC financing and in their most recent fiscal year. The percentage of this employment increase attributable to SBIC financing was determined in the same manner as taxes paid by portfolio companies. This attribution method was based upon the assumption that SBIC financing made assets available for growth and employment increases. The employees attributed to SBIC financing were assumed to earn an average wage of $244 per week (Bureau of Census Statistics) and to pay taxes based upon a single-income household and a median family size (2.78 persons). These employees earned $304.9 million net of Federal income tax payments and paid taxes of $32.9 million. When extrapolated to the population of all SBIC companies, the SBIC-funded employment increase resulted in earnings of $1.692 billion by the workers and $182.4 million in Federal income tax payments.

Costs of the SBIC Program

Direct personnel costs of administering the SBIC program amounted to $1,041,000 for the fiscal year ended September 30, 1979 with indirect costs amounting to an additional $1,041,000. Indirect costs were estimated based on an SBA study indicating that indirect costs amounted to 100% of direct costs. Actual loan losses for 1979 were $1,914,000. Although losses can vary significantly from year to year, this amount approximates the average annual losses for the five preceding years.

The program's administrative costs are small for the economic activity involved because the Small Business Administration need only license and regulate approximately 350 SBICs; each SBIC provides financing and management assistance to an average of 15 small companies. Government loan losses are minimized because the entire private capital of an SBIC must be exhausted before the government loses any money. Combining administrative costs and loan losses, the total costs of the program were $3,996,000.

Cost-Benefit Analysis and Other Observations

The total benefits in terms of taxes paid resulting from the program amounted to $441.3 million compared with costs of $4 million or a benefit to cost ratio of 110. Additionally, the following observations should be noted about the benefits and costs of the SBIC program:

- Many large and successful companies funded by SBIC financing and responsible for large Federal tax payments may not have been covered in the 1979 survey because they had outgrown the need for SBIC financing. Exhibit I lists twelve of the most successful SBIC-financed companies.
- No attempt was made to quantify the "multiplier effect" of the portfolio companies on the rest of the economy.
- The substantial employment increase resulting from the growth of portfolio companies would reduce transfer payment such as unemployment insurance and other Federal benefit programs. This effect has not been quantified.
- Taxes paid by employees of SBICs were not included in the survey; the amount was difficult to determine and was not considered significant to the results of the study.

Exhibit I

Growth in Sales/Revenues

	Before SBIC Financing		*Latest Financial Information*	
	Date	*Annual Sales*	*As of Date*	*Annual Sales*
Company Name		*$ (in millions)*		*$ (in millions)*
Advanced Micro Devices, Inc.	July 1969	—0—	Mar. 1981	309.4
Amdahl	Oct. 1972	—0—	Dec. 1980	394.4
American Microsystems, Inc.	July 1966	—0—	Dec. 1980	129.3
Computer and Communication Tech	Oct. 1969	—0—	Dec. 1980	46.3
Federal Express	Oct. 1973	6.8	May 1981	589.5
Four-Phase Systems, Inc.	Feb. 1969	—0—	Dec. 1980	197.2
Intersil, Inc.	Jan. 1971	3.7	Sept. 1980	166.4
Memorex	Apr. 1961	—0—	Dec. 1980	768.7
Microform Data Systems	Aug. 1968	—0—	Aug. 1980	25.2
Storage Technology	Jan. 1971	—0—	Dec. 1980	603.5
Teledyne, Inc.	Feb. 1963	10.4	Dec. 1980	2,926.4
Tymshare, Inc.	Apr. 1966	—0—	Dec. 1980	235.9
Total for Group		$20.9		$6,392.2

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February 23, 1982

TESTIMONY

of

Patrick Owen Burns
Member of the Board
and Legislative Chairperson
of the AMERICAN ASSOCIATION
OF MESBICS, Washington, D.C.

and

President, Minority Equity
Capital Company, Inc. (MECCO)

before the

SENATE SMALL BUSINESS COMMITTEE

Good morning Mr. Chairman and Members of the Committee. My name is Patrick Owen Burns and I am president of Minority Equity Capital Company, Inc. (MECCO), and board member and legislative chairman of the American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC), which represents over 130 MESBICs across the country.

MECCO, organized in 1971, presently has $2.6 million of private capital provided by seven investors/shareholders. The five original investors, Metropolitan Life Insurance Co., The Ford Foundation, the Episcopal Church, Interracial Council for Business Opportunity (ICBO) and an individual were subsequently joined by FNCB Capital Corp. (Citi Corp's venture capital arm) and IBM. MECCO has "taken down" $1.7 million of SBA leverage of preferred stock and will file within the next two weeks for a further $1.5 million of leveraging. Over the years, MECCO has provided from its own resources, private capital and leverage dollars, over $5 million of financing to some twenty-five companies with economic activity and payrolls in some twenty states and the District of Columbia. MECCO's venture investments directly or in conjunction with other MESBICs triggered or served as the basis for over $50 million of additional capital, frequently for expansion. Our portfolio companies range from publishing, such as Essence, to radio and TV stations in a number of states including Tennessee, New York, Missouri, Pennsylvania, Georgia, Indiana, to manufacturing firms based in plants in Connecticut, Texas, New York, Vermont, serving a nation-wide customer network to distribution and retail chains as well as construction firms.

MESBICs, also known as 301(d) SBICs, are authorized under the Small Business Investment Act of 1958, as amended, to provide venture capital and offer management guidance to a portfolio of small businesses owned by minority entrepreneurs. MESBICs represent a unique private/public sector partnership ((see attached exhibit A listing corporate investors in the MESBIC program) which utilizes the base of long term private capital and the add-on leverage dollars of preferred stock and debentures purchased to expand the pool of capital available to minority owned businesses.

The subject of today's hearings is fundamental to the whole concept of the MESBIC industry--small business and competition. America's small businesses are gaining new recognition as a major force in the national and world economies. With this new recognition comes new responsibilities and the opportunity for new initiatives for both the government and the small businessperson. For MESBICs, just beginning to gather meaningful strength in the marketplace, it is important that public policy, regulatory controls and legislative proposals be relevant and tailored to the existing circumstances. It is equally important that the MESBIC industry be aware of, responsive to and whenever possible, participants in the opportunity developments for small business in general and minority small business in particular.

In the area of public policy development, MESBIC officials have been working with Congress as well as the Administration's policy, financial and tax advisors to develop a comprehensive strategy which will stimulate and support America's small businesses over the next decade. The MESBIC industry has presented the minority business perspective on numerous occasions before the House and Senate Small

Business Committees. We have also worked with a variety of federal agencies in developing regulations which are flexible and responsive to the realities of small business.

Over the past year, AAMESBIC has joined with other small business associations to support federal programs of benefit to the entire small business community. We have consistently encouraged any policy or recommendation which would increase the availability of venture capital for small business. Private business groups have tapped the Association's resources for assistance in eliminating unreasonable regulatory constraints and overcoming bureaucratic inefficiencies.

In recognition of the MESBIC industry's accomplishments and continuing contributions it is making to the American economy, the Administration has recommended $41 million for the MESBIC program in fiscal year '83. This is particularly significant as a recognition of the growing need and increasing positive economic impact in capital development and job creation.

In addition, Congress has exhibited its continuing support for the MESBIC industry. During last year's budget appropriations process, Senator Weicker urged the Senate Small Business Committee to support the MESBIC industry funds based on the vital role MESBICs serve. More recently, Senator Nunn introduced legislation increasing the maximum funding authorization for MESBICs in this year's budget. He stated his belief that the program "fits perfectly into the Senate Small Business Committee's long-standing preference for programs which involve, and rely on, the private sector...The MESBIC industry is a stable, secure, and serious venture capital partner for minority businesses."

In an uncertain economic climate, it is even more important that no policy shifts with regard to the MESBIC industry occur, or even be perceived as a possibility. Giving the high risk area of our investments, together with current high interest rates, any uncertainty as to government policy regarding the MESBIC industry would prove to be a major disincentive to further investments by the private sector in MESBICs. In fact, even the existing capital would tend to be locked into place by MESBICs seeking to insure adequate capital to cover future needs of existing portfolio companies. Only a stable, consistent stance by the administration and Congress will insure the maintenance and work to increase the critical private sector participation and the continuity of a smooth private/public sector working relationship.

The nature of the MESBIC program is not only consistent with, but fundamental to, the goals of the present Administration -- to maximize private sector participation in the economy. In 1980, the MESBIC industry's positive result stand out. Forty Two Thousand ($42,000) Dollars of MESBIC's funds were invested in minority businesses, which generated additional $84 million of private sector financing. Of the total $126 million, only $22 million represented leverage funds from SBA, providing a cost benefit ratio of almost 1:6. When taxes, potential reduced unemployment costs, and other relevant factors are taken into consideration, the final cost-benefit

ratio is almost 1:40 -- an efficiency rate few other government programs are able to claim.

These figures convey only a very small part of what the MESBIC industry has accomplished. In fact, the Association recently contracted with Wharton Econometrics to conduct a more extensive study in further detail of the full nature of the positive impact of the MESBIC industry and its portfolio on the minority business community and the American economy.

Through MESBIC investments and additional capital generated through consortium financing, MESBICs have financed minority entrepreneurs in commercial and industrial manufacturing, communications, transportation, franchising, entertainment, retail and construction. By 1980, MESBICs had invested over $176 million in over 3,000 small business concerns. In 1980, MESBICs invested $42.2 million in 547 financings. The average company generated $818,000 in gross sales and had assets of $616,000. Approximately 24% of these investments were in communications and transportation, 17% in manufacturing and 18% in retail and construction. SBA's preliminary figures for 1981 indicate that the industry invested approximately $54 million in 742 financings, of which 403 were first MESBIC financings of the minority companies involved.

The MESBIC industry and its minority business clients are still in the young growth stage of business development.

While the industry takes some satisfaction in its accomplishments to date, it realizes that the task of capital development, job creation and entrepreneural encouragement remain major uncompleted agenda items. The encouragement and expanding support of the governmental partner in this important private/public sector partnership are important. The MESBIC industry is heartened by the Administration's support and we believe we have begun to build a foundation for the growth of a strong minority business sector for the future.

We appreciate having the opportunity to testify before you today. I will be glad to answer any questions you might have.

Thank you.

Mr. STULTZ. Mr. Chairman, in my prepared statement, I mentioned the David Birch article, and I would like permission to put it in the record.

Senator WEICKER. The committee would like to have that as part of the record, and it will be included in the record at this point.

[Material follows:]

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THE Public Interest

NUMBER 65, FALL 1981

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THE PUBLIC INTEREST is published quarterly by National Affairs, Inc. and appears in Spring, Summer, Autumn, and Winter issues. Its office of publication is located at 10 East 53 Street, New York, N.Y. 10022. Subscription price: $14.00 for one year; $28.00 for two years. Add $2.00 annually for Canadian and foreign subscriptions. Unsolicited material cannot be returned unless accompanied by sufficient return postage. Second class postage is paid at New York, N.Y., and at additional mailing offices. © 1981 by National Affairs, Inc. (ISSN-0033-3557).

Who creates jobs?

DAVID L. BIRCH

As a nation, we must create about 15 million new jobs in the 1980's to employ all of our expanding adult population. This is less than the 19 million we created in the 1970's to absorb "war babies" into the labor force, but it is still quite a large number. Assuming that present attitudes toward government extend at least a few years into the decade, the government sector as a whole will produce no more than one-quarter of the needed 15 million. The private sector will have to produce the rest. All of this will have to take place during a period in which the structure of the U.S. economy is undergoing very basic changes.

As a group of us at the M.I.T. Program on Neighborhood and Regional Change began to think about how the nation will meet this challenge, we came to appreciate how little we knew about the processes by which job creation takes place. Most students of the economy have tended to focus on the aggregate measures of economic change flowing out of the GNP accounts, and have not probed the activities of the individual companies that make it all happen. These analysts may guess about what kinds of corporate behavior are causing shifts, but they never really know for sure.

On the other end of the spectrum, those who have studied the behavior of individual corporations rarely have added up the firms

to see how they come together to create the whole. "Input-output analysis" is one of the major exceptions to this, focusing as it does on transactions between businesses in the economy. Welcome as this innovation has been, it has suffered (as have other attempts to aggregate parts to form economic wholes) from the enormous cost of collecting the necessary data. As a result, it tends to be out of date, and its results are expressed in terms of transactions between whole industries, not between firms.

Our inability to understand the gap between the "micro" economy and "macro" economy is now seriously hampering efforts to develop policies that will generate jobs for the people and the places that need them, without causing inflation at the same time. We know very little about who the major job creators are, where they are active, who controls those jobs, and who is most likely to respond to changes in economic policy. In the absence of such knowledge, national policy has been to stimulate the entire economy as though it acted as a single unit, using instruments like broad tax incentives, easier access to money, and public works programs of various sorts. This can be a very expensive and inflationary approach if, in fact, most of the recipients do not use the incentives to increase employment and productivity. What we need, and have lacked, is the ability to focus our incentives on those who will make good use of them without wasting taxpayers' monies on those who will not.

Frustrated by the inability to relate micro to macro, and thereby to discover how change takes place, our group at M.I.T. began casting about for a new data source that would permit us to analyze inexpensively a large sample of the entire corporate population, one establishment at a time. Our search uncovered the so-called DMI file created by the Dun and Bradstreet corporation. The file contains records for about four million establishments, about 80 percent of the total recognized establishments in the country. We devised a way to combine the data for each establishment for four different years (1969, 1972, 1974, 1976) to obtain a history of the development of each establishment during this period. In the process we added in new firms that were formed along the way, yielding a total of about 5.6 million establishments over the seven-year period. We also edited the records extensively to eliminate establishments for which the data seemed at all questionable. When we were done, we were able to trace what happened to the employment, sales industry, corporate affiliation, age, and location of each establishment over this time. By aggregating establishments, we could see who was contributing to job growth in different periods and places.

TABLE I. *Percentage of Job Losses and Gains by Growth Rate for States*[1]

STATE GROWTH RATE[2]	FAST	MODERATE	SLOW	DECLINE	U.S. AVERAGE
1969–72:					
Gains	13.8%	10.9%	8.5%	7.5%	10.4%
Losses	8.3	8.0	7.7	8.4	8.1
Net	5.5	2.9	.8	−.9	2.3
1972–74:					
Gains	12.4%	10.1%	9.0%	—	10.9%
Losses	7.2	7.2	7.6	—	7.2
Net	5.2	2.9	1.4	—	3.7
1974–76:					
Gains	15.1%	11.4%	10.7%	8.3%	11.2%
Losses	8.9	8.7	9.7	9.3	9.2
Net	6.2	2.7	1.0	−1.0	2.0

[1] Source: M.I.T. Program on Neighborhood and Regional Change.
[2] The four classes of employment change are: Fast (over 4 percent per year), Moderate (2 to 4 percent per year), Slow (0 to 2 percent per year), and Decline (less than 0 percent per year). On the average, this breakdown divides states into four roughly equal groups, although the size of the groups in any particular year is sensitive to the business cycle.

Job creation is what really matters

For any particular place, it turns out that there are six quite different ways that an establishment can affect an area's job base. On the plus side, jobs are added to the pool each year whenever a new firm starts up, an existing firm expands, or a firm located elsewhere moves in. Jobs are lost whenever an establishment closes its doors, lays off people, or moves out. We have come to call these six "job flows": *births* (a new firm starting), *expansions, in-migrants, deaths* (an existing firm closing its doors), *contractions,* and *out-migrants.* The extent to which an area's job pool expands or contracts in total over the year depends on the relative balance between these flows during the year.

We discovered a number of interesting things about the job flows. First, *virtually none of the employment change in an area is due to firms moving,* in the sense of hiring a moving van and relocating. Many firms move short distances each year, but virtually none move from one metropolitan or rural area to another. When a move does occur, it is widely publicized in the press, and it is easy (without evidence to the contrary) to begin to pin all of an area's economic woes on the fleeing firm. Any hard look at the numbers, however, will show that fleeing firms take only a small number of jobs with

them, and that for every firm that flees there tends to be another firm with a similar number of jobs moving in. The net effect of firm "migration" is thus negligible relative to the job base (and the other job flows) for most places.

The second striking phenomenon observed in the analysis of employment change is the constancy of job losses. Every area in the United States seems to lose jobs at about the same rate, regardless of how rapidly the net job pool is expanding or contracting. Table I sorts states into different groups by growth-rate and displays the gains and the losses for each group in each of the three periods studied. As can be seen, virtually all the differences in the net change are due to differences in the gain rates, the sum of the loss rates being remarkably similar across states. There is a variation in average loss rates over time with the business cycle in the expected directions, but all states seem to float up and down together on the loss side, varying between seven and nine percent.

The same phenomenon appears to hold across cities, and even within them. Table II summarizes the loss and gain rates for ten metropolitan areas for which the neighborhood location of each business has been located. The differences in loss rates are relatively small, and if anything the more rapidly growing areas also experience the highest losses. Houston and Charlotte show somewhat higher loss rates than Worcester and New Haven, for example. Again, it is the variation in the gain rates that is so large, the rapidly growing areas replacing lost jobs at two or three times the rate of the declining ones. The same general phenomenon is ob-

TABLE II. *Percentage of Firms Gained and Lost in Ten Metropolitan Areas, 1972-76*[1]

AREA[2]	PERCENT GAIN	PERCENT LOSS	PERCENT NET
Houston	62.7%	35.7%	27.0%
Charlotte	48.0	40.4	7.5
Dayton	36.4	31.4	5.1
Rochester	33.7	29.3	4.5
Boston	37.4	33.7	3.8
Baltimore	36.5	32.9	3.5
Hartford	36.6	35.5	1.1
Worcester	24.6	25.1	− .5
New Haven	27.0	29.5	−2.6
Greenville	26.9	35.1	−8.4
U.S. Average	37.0%	33.7%	4.1%

[1] Source: M.I.T. Program on Neighborhood and Regional Change.
[2] Standard Metropolitan Statistical Areas.

served for the central cities and suburbs within these metropolitan areas.

The average loss rate is also quite high. An eight percent loss every year means that half of an area's jobs and establishments must be replaced every five years for the area simply to break even. We seem to have developed an economic system in which experimentation and risk-taking are very common. As a consequence, we experience and tolerate very high failure rates. The more dynamic the local economy (e.g., Houston) the greater the risk-taking and the greater the proportion of firms that fail. It could easily be argued (without being facetious) that one of our greatest strengths as a nation is our capacity for failure—the grace and even enthusiasm with which we accept those who try and fail and come back to try again. To our counterparts in the industrial world, this churning in our system seems extraordinary. We take it for granted, and at times even try to stifle it under the misguided banner labeled "job retention." *The reality is that our most successful areas are those with the highest rates of innovation and failure, not the lowest.* Areas that are declining are not declining because their rates of loss are higher. They are declining because they are not competing effectively for new jobs.

Those small, volatile job replacers

Since we turn over such a large proportion of our job base every year—in all industries and all areas—the overall character of our economy is affected quite quickly by the nature of the job replacers. It no longer takes generations to transform our economy—only a decade or two. We must thus focus our attention on the job replacers. Who are they? In what sectors of the economy are they found? How big are they? How old are they? Where are they located?

For one thing, job replacers tend to be small. Of all the net new jobs created in our sample of 5.6 million businesses between 1969 and 1976, two-thirds were created by firms with twenty or fewer employees, and about 80 percent were created by firms with 100 or fewer employees (see Table III). Smaller businesses more than offset their higher failure rates with their capacity to start up and expand dramatically. Larger businesses, in contrast, appear rather stagnant. They may be expanding output with more capital equipment (although those who study productivity suggest that this has not been the case recently) or they may expand by opening opera-

TABLE III. *Percentage of Jobs Created by Size of Firm and Region* [1]

NUMBER OF EMPLOYEES IN FIRM	PERCENT OF JOBS CREATED				
	Northeast	North Central	South	West	US. Average
0-20	177.1%	67.2%	53.5%	59.5%	66.0%
21-50	6.5	12.0	11 2	11.6	11.2
51-100	−17.4	5.2	5.5	6.3	4.3
101-500	−33.3	3.1	9.4	9.3	5.2
501+	−32.9	12.4	20.4	13.3	13.3
Total	100.0%	100.0%	100.0%	100.0%	100.0%

[1] Source: M.I.T. Program on Neighborhood and Regional Change.

tions abroad. Whatever they are doing, however, *large firms are no longer the major providers of new jobs for Americans.*

Another distinguishing characteristic of job replacers is their youth. About 80 percent of the replacement jobs are created by establishments four years old or younger (see Table IV). Not all small businesses are job creators. The job creators are the relatively few younger ones that start up and expand rapidly in their youth, outgrowing the "small" designation in the process.

Job creators are also quite volatile. The road to future growth is a tortuous one indeed. We had thought that a firm grows and develops much like a human being: It starts small, grows smoothly and rapidly during a "growth phase," matures and stabilizes for some period, and eventually becomes out-dated and falls off. Our research now suggests quite a different process. Dynamic, job creating establishments appear to oscillate, or pulsate, constantly. Periods of expansion are the best predictors of future decline, and declining periods are the foundation upon which future business growth is based.

TABLE IV. *Percentage of Replacement Jobs Created Between 1974 and 1976 by Age of Establishment and Region* [1]

AGE OF BUSINESS	PERCENT OF REPLACEMENT JOBS CREATED			
	NORTHEAST	NORTH CENTRAL	SOUTH	WEST
0-4	75.5%	80.8%	80.4%	80.9%
5-8	10.4	8.4	9.9	8.8
9-12	7.5	6.0	5.1	5.5
13+	6.6	4.8	4.6	4.8
Total	100.0%	100.0%	100.0%	100.0%

[1] Source: M.I.T. Program on Neighborhood and Regional Change.

TABLE V. *Performance of Establishments based on Their History of Growth*[1]

1969-1972 History	Percent in 1974-1976 with: Rapid Growth	Rapid Loss	Death
Rapid Growth[2]	11.1%	16.5%	4.3%
Small Change	9.4	7.6	24.6
Rapid Loss[2]	21.9	8.0	12.6

[1] Source: M.I.T. Program on Neighborhood and Regional Change.
[2] Greater than 50% change.

Stable firms, those that have somehow isolated themselves from the ups and downs in the world around them, are the most likely to fail in the end. A sample of 1.4 million establishments that existed throughout the 1969-76 period shows that establishments that grew sharply in the past are the most likely to decline in the future, that recently declining establishments are the ones most likely to grow in the future, and that stable firms are far and away the most likely to go under (Table V). These oscillations from one year to the next are much greater than the average growth or decline that one would expect from a "life-cycle" model of corporate change. Those firms that insulate themselves from fluctuation appear to have cut off the very vitality that keeps their counterparts going. Just as failure appears essential to our system, so does instability.

Recent job replacers overwhelmingly tend to be providers of services—broadly defined to include all those private activities outside of the so-called "goods-producing" sector (manufacturing, agriculture, mining, and construction). During the period we studied, manufacturing firms in our sample actually lost jobs on balance, this small loss being offset by substantial gains elsewhere. The older, more northern, and more urban the area, the more this was true. Manufacturing picked up slightly nationwide during the latter part of the decade, but by the time the 1970-1980 U.S. figures were in, manufacturers as a group had created only 5 percent of the net new jobs in the 1970's and the goods producers as a whole accounted for only 11 percent. The other 89 percent were in services of one kind or another. Just as we moved in the 1820's and 1830's from being a basically agricultural society to being an industrial one, so now are we rapidly abandoning our heavy industrial base in favor of jobs that demand greater use of our minds and less use of our muscles and dexterity.[1]

[1] There are bright spots within the sluggish manufacturing sector including very small manufacturers and high-technology, high "thought-content" firms. The bright spots are not bright enough, however, to significantly offset the general malaise elsewhere.

These basic shifts in the nature of job replacement are not unique to the U.S., although we tend to be further advanced along this path than other nations. Nor are the findings unique to our data set or approach. Others, here and abroad, using different ways of measuring the behavior of individual firms, are finding much the same thing.

The transformation is thus a fundamental and far reaching one. We are moving from manufacturing to services, from hardware to "thoughtware," from large-scale capital-intensive companies to smaller-scale labor-intensive companies, and from a dependence on physical capital to a dependence on human capital. These shifts have been facilitated by the increasingly international nature of our economy. We no longer have to make what we consume. Instead, we increasingly create and market products that we let others assemble for us. As a result, our exports and imports have risen from 7 percent of GNP in 1950 to 15 percent in 1979, and our private assets abroad have increased from $19 billion to $377 billion over roughly the same interval.

Intervene or improve the climate?

Those who would try to influence our economic system during this sometimes difficult period of transition are faced with some very thorny problems. At the heart of the matter is the age-old problem of choosing between a direct interventionist policy or an indirect improve-the-climate policy.

Those advocating a direct policy would have us provide assistance to individual companies or industries through government actions of some sort—loans, loan guarantees, contracts, grants, import restrictions, etc. Going the climate-improvement route involves changing the general tax and regulating environments in ways that entrepreneurial business people find attractive, thus letting the market determine who flourishes and who does not.

A direct policy is, and always has been, a "natural" for governments. It gives them a feeling of accomplishment—a series of deals (and jobs created) that they can point to with pride. Thus, it is not surprising to find that we have a broad array of such programs spanning several administrative branches of government, from the federal to the state and local levels.

In view of our findings on job creation and shifts in the economy generally, it appears that a direct intervention will become increasingly difficult (and frustrating) to administer. How, for instance, is

an official at any level of government going to decide whom to aid? In the past, the most natural choice has been the large, stable, well-known companies because they could easily be identified (their well-financed lobbyists made sure of that) and because their risk of failing in the short-term was minimal.

But these are the companies that are the least likely to create jobs. And assisting them has a long history of not working. The Dutch and British, who have gone much farther down this road than we, have had many failures and very few successes. Our own experience, while far less extensive, is not too encouraging either. Propping up large-scale, noncompetitive private bureaucracies seems to subsidize incompetence rather than cure it.

If these same interventionists choose to redirect their efforts toward the smaller end of the scale, their problems are no less severe. How will they pick the one out of 100 or 300 small firms that will become a major job creator? How will they absorb the enormously high transactions cost associated with making thousands (or hundreds of thousands) of small-scale interventions? How will they endure the embarrassment and threat of scandal associated with a project failure rate of 30, 40, or 50 percent? These problems are not unique to government agencies. They explain in great measure why banks, insurance companies, pension funds, and university endowments are equally hesitant to become involved in small-business affairs, and why some very high percentage (in the range of 80 to 90 percent) of all startup and expansion capital for smaller businesses comes from immediate, personal sources: personal savings, friends, and relatives.

Furthermore, smaller businesses apparently do not want direct assistance. Not a single recommendation coming out of the recent White House Conference on Small Business asks that government programs or regulations be increased. The practically universal cry of owners of small businesses is that governments establish a more favorable climate and let entrepreneurs run their businesses as only they know how.

This cry, and others like it, have led many in Washington to consider seriously the value of a predominantly "climate" policy. Its purpose would be to create an environment in which innovative, job-creating firms flourish. Since smaller businesses appear to be playing an increasingly important role in the economy, special attention is being paid to their concept of a good economic environment. Following their recommendations to the White House Commission on Small Business, the list of improvements would include:

(1) lower personal taxes on capital gains, (2) lower estate taxes (so companies may be kept within a family), (3) a slower rise to the full corporate tax rate (to compensate for the unintended progression into higher brackets caused by inflation), (4) fewer and simpler regulations, (5) simpler depreciation rules, and (6) equal opportunity for smaller business in goverment procurements.

We should not infer from the recent interest in climate policies that they are universally embraced by governors and mayors. For one thing, there would be a relatively small role for these elected and appointed officials to play in the management of our economy. There are also definite problems associated with depending entirely on smaller businesses to create jobs. They have little capacity for example, for conceiving, developing, and marketing the kinds of products and services that can only be provided on a large scale—jet aircraft, large-scale integrated circuits, space shuttles, communications satellites, telephone service, etc. Smaller businesses seem to function much better as subcontractors to larger companies in these situations, relying on the larger company for the design and international marketing aspects of the job.

The reindustrialist illusion

The choice between direct intervention and climate policies will ultimately depend on what we wish to accomplish. An increased emphasis on business climate will more than likely accelerate the trend toward the dominance of smaller service-sector firms as the sources of new jobs in our economy, an increasing dependence on foreign countries for manufactured goods, and an increasing dependence on investments in human capital rather than physical capital, with all the attendant declines in measured productivity that would entail.

There are some who find this natural trend threatening. Pointing frequently to the Japanese and their increasing dominance of what used to be many of our markets, they advocate that we "reindustrialize"—that is, go back to investing more in plants that will make things more efficiently so we can meet foreign competition in markets we are now losing. Since our private sector companies do not seem to be doing this on their own, the argument goes, some form of intervention is called for.

There are several problems associated with this attempt to roll back the clock. First, it is not clear what "universal solvent" we dip our noncompetitive industries into so that they suddenly become

creative again, invest in new technologies, and work harder. Protective tariffs and import restrictions will certainly not accomplish it. Forced savings by households and businesses to finance needed physical capital (a common practice in Japan) is certainly not part of our culture.

Secondly, it is not clear that we *should* devote a tremendous effort to find a universal solvent. In our almost compulsive fascination with the Japanese and the effectiveness with which they have competed in certain markets (automobiles, electronics, watches, etc.) we lose sight of our competence in producing the "thoughtware" upon which so much of the Japanese hardware is based. It is not an accident that of the 176 Nobel science prizes awarded since 1950, the United States has received 93, the European community another 68, and Japan only two. We dominate the thoughtware field just as others are coming to dominate hardware production. And the emphasis in many fields is shifting from hardware to thoughtware. It was not uncommon five years ago for 90 percent of the cost of a computer installation to be in hardware, and only 10 percent in thoughtware (software, as the computer industry calls it). Five or ten years from now, it will not be unusual for those percentages to be reversed—80 or 90 percent software and only 10 or 20 percent hardware. For many of the same reasons, *Robotics Age* (one of the journals of the blossoming robot industry) recently changed its name to *Robotics Age: The Journal of Intelligent Machines*, saying: "... the character of the industrial robot market is rapidly moving towards increased intelligence in the controller. As this happens, the nature of the problems, both in design and application, is quickly changing from hardware to software."

What it comes down to, then, is this: Do we want to try to beat the Japanese (and others like them) at their game or play our own game instead? The evidence we have collected suggests that: (1) the odds of our beating them at their game are slim, and (2) that we are doing quite well at our own game if we can recognize it for what it is. We have spawned an extraordinary number of idea factories—in universities, businesses, and government—that generate a high percentage of the world's original ideas and that now provide employment for a greater percentage of our work force than ever before in history. In the absence of a major international conflict, this division of labor between ourselves and those who choose to make things is not necessarily bad and could well, given present trends, turn out very much in our favor.

We pay a price during a transformation of this sort. The relatively

few workers who still make things in factories[2] must adjust to different kinds of employment. Our enormous mobility gives us an advantage over other nations whose people are less mobile. But we are still left with older, skilled craftsmen for whom moving and retraining does not come easily.

Also, in the unfortunate circumstance that we enter another world war, our dependence upon others for manufactured goods could turn out to be a major liability. It already is. Every time imports rise as a percent of our GNP, our dependence increases. Furthermore, to the extent that our dependence is concentrated in selected areas (transportation equipment, electronics, computers, steel, petroleum) the effect could be even more crippling. We have experienced it recently in oil; the Russians are now feeling it in food.

National security is a major, compelling argument for stemming the present tide. It is a strong argument, and is not easily dealt with. Patriotism alone will not make our automobile plants or our steel plants or our computer plants more competitive. Nor are trade barriers and protection likely to lead to the superior technology we would need to succeed in the very conflict we are hedging against. In short, we still seem to lack the "solvent" to transform our noncompetitive industries in peacetime even if we decided, as a national policy, that it was important to do so.

Thus develops a more interdependent collection of nations in which we play a specialized role. Luckily ours is one of the more interesting and promising parts in the play. And we seem, without strong supporting policies, to be developing a mix of larger and aggressive smaller businesses to play our role well. Perhaps we should spend less time worrying about what the Japanese do better, and worry instead about how to do better what we do best.

[2] About 13 percent of the workforce is still engaged in actual manufacturing operations, as distinguished from those who manage or sell or account for the goods made by the others in firms labeled "manufacturing."

Senator WEICKER. Thank you, gentlemen.

We will stand adjourned.

[Whereupon, at 11:15 a.m., the committee recessed, to reconvene at the call of the Chair.]

APPENDIX

The Small Business Coalition for Pollution Control

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February 23, 1982

Senator Lowell P. Weicker
Chairman
Senate Committee on Small Business
424 Russell Senate Office Building
Washington, D. C. 20510

Re: Request to File Written Statement
Small Business Administration Pollution Control Facilities
Financing Guarantee Program

Dear Mr. Chairman:

The Small Business Coalition for Pollution Control respectfully requests that the Statement forwarded herewith, addressed principally to the position of the Administration with respect to the Small Business Administration's pollution control facilities and equipment guarantee program, be included in the permanent hearing record. We believe that the Statement adds substantially to the oral testimony made at the hearing earlier today on this matter and refutes convincingly the positions taken by the Administration.

Respectfully requested,

Randal C. Teague

RCT:ms
Enc.

STATEMENT OF RANDAL C. TEAGUE, ESQ., COUNSEL TO THE SMALL BUSINESS COALITION FOR POLLUTION CONTROL, BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS, WASHINGTON, D.C., FEBRUARY 23, 1982.

THE SMALL BUSINESS ADMINISTRATION'S POLLUTION CONTROL FACILITIES FINANCING GUARANTEE PROGRAM: A CASE STUDY IN WELL-INTENTIONED MOTIVES APPLIED DISASTROUSLY TO A SPECIFIC PROGRAM

Mr. Chairman and Members of the Committee:

You and the Committee are to be congratulated for holding these hearings. Their focus on the roles of Federal guarantees of private sector loans and the benefits to the economy to be derived from them is crucial to determining what should now be done.

Few in business know the adverse impacts of the Federal Government's "crowding out" of available capital more than small businesses. Small business is usually the first driven out of the capital market and the last back in. It is the first hit by the high interest rates which inadequate capital produces.[1]

The concern which we express here today is that summary policy objectives designed to reduce both the Federal Government's crowding out of available capital and tax revenue

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[1] The November 1981 report of the National Federation of Independent Business, "Report on Small Business in America's Cities," ranked problems posed by high interest rates as the number one problem among the small businesses surveyed.

losses to the Treasury may reach and destroy specific programs without an adequate understanding on the part of those persons who formulated the policy objective of what the real consequences to those objectives will be. These include consequences which undermine other economic policy objectives: jobs creation, increased productivity and tax revenue generation. We believe this is the case here.

The Small Business Coalition for Pollution Control

I am Randal C. Teague, Counsel to The Small Business Coalition for Pollution Control, on whose behalf this Statement is offered. I serve in that capacity as Counsel to the Washington office of Vorys, Sater, Seymour and Pease, a Columbus, Ohio general civil practice law firm of national reputation in the relevant corporate, bond and environmental compliance areas.

The Coalition was organized last year to heighten the awarenesses of Congress, the Administration and the public on the alternatives before them in determining the future of the Small Business Administration's pollution control facilities and equipment financing guarantees program.

This Coalition represents the small businesses which have, on the one hand, been required to install pollution control facilities and/or equipment in order to meet pollution control objectives of the Government and which, on the other hand, would face either (1) noncompliance with the statutes, regulations,

plans and orders reflecting those policies, or (2) a sale to a bigger business with more assets and borrowing leverage, or (3) insolvency and reorganization, if forced to over-leverage against net worth made lower by the borrowing, or (4) going out of business.

The president of the Coalition is Jack L. Schaefer, president of The Specialty Papers Company, a small business printing company in Dayton, Ohio. The company is an SBA loan guarantee applicant, and its officers and employees are aware of the consequences of a failure by the Reagan Administration to act in a timely way to allow SBA to proceed with this program (1) at an annual authority level consistent with the law (P.L. 97-92, the FY82 Continuing Resolution) and (2) with the guaranteeing of tax-exempt bonds, a guaranteeing consistent with the statutes, their legislative history and six years' experience.

The Coalition is not a permanent trade association. If the issues associated with it go away, the Coalition expects to go away too. But, we will be intensely active until it does.

The Issues

Why is this Federal Government guaranteed, tax-exempt financing necessary? Principally for two reasons:

1. Extensive facility and equipment expenditures are necessary to control air and water pollution and solid waste disposal in order to comply with Federal environmental policy objectives; and

2. Obtaining ordinary debt financing without SBA guarantees is nearly impossible because of the disproportionate cost of the equipment in relation to most small businesses' net worth and profitability and because the equipment itself generally has little value as collateral.

Yet, issues have surrounded the program over the past year.

When the Coalition was organized last year, there were three issues. They were:

1. The level of FY82 annual authority to be apportioned to SBA for this program by the Office of Management and Budget;

2. A resolution of the tax status of the bonds to be used to finance pollution control facilities and equipment; and

3. Whether the personnel ceiling for SBA's Pollution Control Financing Section, a ceiling also controlled by OMB, would be adequate to permit that Section to close on guarantees equal to the annual authority level.

We knew that if any link in this three-link chain broke, the SBA pollution control facilities guarantee program would be severely endangered. This is still true.

These three issues remain. Only two things have happened: First, they have been more precisely defined and, second, this has occurred because OMB has acted by fiat as to the first and second issues and not at all as to the third. The Coalition and its members believe the OMB actions as to the first and second issues to be outside the law.

Briefly, what is <u>this</u> program?

History of the SBA Pollution Control Facilities Program

The Small Business Administration's pollution control facilities financing program is really a pollution control facilities and equipment financing program. It was authorized by sections 102-103 of the Small Business Investment Act of 1976 (P.L. 94-305, 90 Stat. 663, 15 U.S.C. 692, 13 C.F.R. 111) in order to allow small businesses to obtain access to the tax-exempt bond markets for the financing of plant changes and equipment mandated by pollution control (air and water pollution control and solid waste management) regulation of the Government.

That Act authorized SBA to guarantee up to one hundred percent of the payments due from eligible small businesses under qualified contracts for the planning, design, financing or installation of pollution control facilities and/or equipment.

The current limit on a loan guarantee is $5,000,000 principal plus interest, and the average is $1,200,000. The maximum term of the loan is 30 years; the average is 20 years. What is guaranteed is a qualified contract, and the applicant must demonstrate the need to overcome financing disadvantage in order to qualify. The applicant pays a guarantee fee of 3.5 percent times principal plus interest, less an escrow deposit of 3 monthly payments. In the event of default, payment is made from the escrow fund first, then from the fund created by the guarantee fees collected and the interest earned thereon. The $15 million revolving fund established by Congress at the

beginning of the program has grown through the addition of these fees to over $30 million, and it is our understanding that the only defaults in its history are being, or can be, recovered by SBA through subsequent agreements with the defaulting small businesses.

The crucial need for the program has been reflected by the growth in applications received and loan principal guaranteed, a growth which has not diminished even during the past year's disruption of the program. In a capsule, the growth and the need that growth reflects has been as follows:

Year	Companies Assisted	Principal	Aver. Prin./Co.
FY77	12	$ 5.7 million	$ 475,000
FY78	14	9.9 million	707,143
FY79	45	41.5 million	922,222
FY80	77	98.5 million	1,279,220
FY81	66	99.9 million	1,513,636

It must be stressed here that the number of applicants measured against the limited available authority assures that this program is indeed one of "last resort."

The Issue of FY82 and FY83 Authorities

The issues before this Committee today are whether this program, under the twin OMB stranglehold of $150 million in annual authority and no guaranteeing of tax-exempt bonds, will survive in any real, viable way, and if it does, whether small

businesses which rely on it under the same conditions and as a "last resort" will then survive.

If the law is followed, this SBA program will constitute $250 million or approximately fourteen-hundredths of one percent (0.0014%) of total Government guarantees in FY82. If the OMB apportionment of $150 million is followed, it will constitute only five-hundredths of one percent (0.0005%).

Why is the Administration So Concerned?

It should be noted that the Federal Government's intrusion in the capital marketplace is not only by Federal credit and loan guarantees but also by its own borrowing for its own public debt purposes. The Administration is rightly concerned about this additional component of its crowding out of available capital, but many persons are left with the impression that the Administration's "crunch" on the credit and loan guarantee side is of greater interest to it than its concerns on the deficit borrowing side. One could even make a credible argument that the loan and credit guarantee "crunch" is a direct product of the Federal Government trying to offset indirectly the additional impact of its own borrowing and that by doing so it puts the burden of reducing the total Federal Government crowding out on the backs of the private sector and the productive economy, i.e., private borrowing is disadvantaged in order for public borrowing to be advantaged. What an ironic policy objective within this Administration!

This is no longer speculation. On January 14, 1982 I wrote a letter to the Assistant Secretary of the Treasury for Domestic Finance, Mr. Roger W. Mehle, Jr., setting forth arguments similar to those set forth in this statement and asking Treasury to initiate a thorough review of the application of its broad-reaching policy directives as to Federal credit and as to tax-exempt financing in this particular program.

By letter of February 4, Assistant Secretary Mehle responded. In that response is a particularly revealing paragraph:

> "Let me emphasize the reasons this Administration is strongly opposed to Federal guarantees of tax-exempt obligations. Placing the credit of the United States behind an obligation that is exempt from Federal taxation would create a security which would be superior in the market to the direct obligations issued by the U.S. Treasury. The Public Debt Act of 1941 prohibits the Federal Government from issuing tax-exempt obligations directly. It would therefore be contrary to the spirit of that Act to authorize the issuance of tax-exempt securities that are backed by the credit of the Federal Government." (Emphasis added)

Comments are in order.

First, we find it interesting that the spirit of a 1941 Act is given precedence over the letter of the subsequent Small Business Investment Act of 1976 (Public Law 94-305) and over the legislative history of the Joint Resolution making further continuing appropriations for the fiscal year 1982 (Public Law 97-92). Apparently, Assistant Secretary Mehle is not familiar with the relevant canons of legislative construction to which his policy would be held in a court of law, to wit: That the letter of the law takes precedence over the spirit and that, when there

is conflict between legislative enactments (or legislative intents), the most recent in time takes precedence.

Second, one has a feeling that the "spirit" derived from the Public Debt Act of 1941 was an afterthought, sought and found subsequent to a decision in order to justify it, for this "spirit" was not an impediment to the first five years of this program. Nor is there really any legal or factual basis in this 1941 Act for his position.

I assume that Assistant Secretary Mehle is referring to Section 4(a) of the Public Debt Act of 1941 (Public Law 77-7, 55 Stat. 7, 9), an Act of February 19, 1941 which increased the debt limit of the United States to $65 billion and provided for the Federal taxation of future issues of obligations of the United States, principally First and Second Liberty Bonds, U.S. savings bonds and U.S. Treasury savings certificates. Section 4(a) reads in part:

> "Interest upon, and gain from the sale or other disposition of, obligations issued on or after the effective date of this Act (March 1, 1941) by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations shall not have any special treatment, as such, under Federal tax Acts now or hereafter enacted ...."

An examination of the legislative history surrounding this Act and its prohibition against the tax exemption of the obligations in question reveals a distinction so great from the bonds guaranteed until December 31, 1981 by the SBA through its pollution control facilities financing program as to prove that Assistant Secretary Mehle is either talking about apples and oranges or blowing smoke.

The principal impetus behind the 1941 Act was to relieve Treasury of the likelihood of major tax losses, because it had become apparent that the meeting of war expenditures would push the U.S. Government public debt not only beyond the previously authorized ceiling but also beyond the $65 billion ceiling established by this Act and, further, that aggregate interest earned by obligation holders would soon grow dramatically. Although the U.S. entrance into the Second World War was ten months in the future, the U.S. Government was already making heavy expenditures in association with the war raging in Europe and with general U.S. military preparedness. The 1941 Act, in part, amends the "Act to provide ways and means to meet war expenditures" approved June 13, 1938. However, the matter is deeper than this.

The legislative history is clear that what was the guiding principle behind the enactment of the prohibition on tax exemption of these obligations was the realization that these obligations produced no tax revenues to offset the tax losses which would occur from tax exemption. These U.S. Government obligations had no offsetting tax revenue gains. This is what makes the premises underlying Assistant Mehle's position irrelevant. The SBA guaranteed bonds, on the other hand, do have offsetting tax revenue gains. They are in the form of Federal corporate taxes paid by the small businesses and Federal individual income taxes paid by their officers and employees, some 250 businesses and 20,000 employees in the history of the

program to date. Each time a small business obtains tax-exempt financing and remains in business thereby, revenues are increased in the best case circumstances and maintained in the worst case circumstances. We know today, further, that the absence of the SBA program would run a high risk of tax revenue losses arising from those businesses closing down and laying off their employees.

Fourth, there is an arrogance in the assertions made by Assistant Secretary Mehle which cannot go unmentioned. It is an arrogance which arises from believing that because one has thought of an impediment to an existing policy that it is the first time anyone has thought of it. The arguments raised by Assistant Secretary Mehle were fully considered by Congress in its 1975 and 1976 consideration of the legislation which led to the enactment of this SBA program, and those arguments were rejected in the legislative and constitutional processes of the formulation of this law. I call his attention to the text of the House (then Select) Committee on Small Business' 1975 report, "SBA Assistance for Agricultural Concerns and to Meet Pollution Control Problems" as proof of this.

Fifth, the assertion that an SBA guaranteed instrument is "superior in the market to the direct obligations issued by the U.S. Treasury" is a misunderstanding, at best, of the capital marketplace. One would think that an Assistant Secretary who had been involved previously in the private sector in this kind of program would know better. Does paying a lower rate of interest

make pollution control bonds superior? What about the competition against them from the indirect obligations of the U.S. Government, especially those of government corporations, e.g., the Tennessee Valley Authority or the Bonneville Power Authority, whose obligations are guaranted and the income from which is tax-exempt?

Can the Government of the United States be so concerned about its credit and anticipated FY82 and FY83 borrowing that it believes guaranteed tax-exempt pollution control bonds are marketplace threats to that borrowing and the full faith and credit of the United States?

Mr. Chairman, I ask that my and Assistant Secretary Mehle's letters, as well as a similar one from OMB Assistant Director for Economic Policy and Planning, Lawrence A. Kudlow, be incorporated as appendices to this statement.

Has the Administration Acted without Regard to the Constitutional Process?

What else has happened to this program?

In chronological sequence, what has happened is as follows:

o Legislation (S.580) was introduced last year to increase the annual authority for this program to $250 million. A hearing of the Senate Committee on Small Business was held on May 7, 1981 at which time the Administration opposed the increase and reiterated its intention to reduce the annual authorizations from $110 million to $100 million in FY81 and from $125 million to $95 million in FY82.

o The Budget enacted in August 1981 as Public Law 97-35 authorized the SBA Administrator to proceed at an FY82 annual authority level of $250 million.

o The Departments of State, Justice and Commerce Appropriations legislation (H.R. 4619) enacted by the House and sent to the Senate provided for a $250 million authority, and, further, the chairman of the relevant Senate Committee on Appropriations subcommittee, Sen. Lowell P. Weicker, who is also the chairman of the Senate Committee on Small Business, stated his support for that House-passed level on the Senate Floor.

o On November 5, 1981 the Administration announced an additional program to reduce Federal loan guarantees in FY82 by $20.3 billion, from $181.4 billion to $161.2 billion. SBA loan programs in the aggregate were reduced $1.0 billion or 16%. [I will return to this November 5 announcement.] Notwithstanding these enactments and statements of Congressional intent, the Administration, through OMB, then apportioned only $40 million for FY82 First Quarter.

o Both Houses of Congress then set forth a unanimous intent in the considerations of the mid-November Continuing Resolution, an intent that the FY82 authority level was to be no less than $175 million, that is a floor rather than a ceiling. This legislation was vetoed by the President on other grounds.

o The Congress then set forth a unanimous and again clear intent in the subsequent Continuing Resolution (House Joint Resolution 370) that the FY82 authorization level was to be no

less than $250 million (again a floor), the level originally set forth in S. 580 and Public Law 97-35. Anyone doubting the unmistakable clarity of that intent should read the colloquy of Senators Hayakawa and Weicker at page S14989 and the colloquy of Senators Garn and Levin at page S14994 in the Congressional Record of December 10, 1981. This Continuing Resolution was signed by the President. It is Public Law 97-92.

o That law notwithstanding, OMB then apportioned only $150 million in FY82 authority for the program and with a proviso which crippled it. The proviso prohibited the guaranteeing after December 31, 1981, of payments on any any bond which was tax-exempt. This is a prohibition without statutory, legislatively historical or experiential bases. The attack on tax exemption was, as it remains, another Administration objective, and it was attached to the apportionment document with a kind of administrative fiat atypical of a government of laws.

o Lastly, in the "Proposed Supplementals and Rescission Proposals" section of the Appendix to the Budget for FY83 at page III-41 we find the Administration's request, as follows:

> "Pollution Control Equipment Contract Guarantee Revolving Fund
>
> "(Appropriation language now requested, existing legislation)
>
> "During fiscal year 1982, within resources and authority available, total commitments to guarantee shall not exceed $150,000,000 of contingent liability for principal.
>
> "This proposal would increase the request for new 1982 guarantee commitments which offsets a small portion of the reduction in the commitment to guarantee loans for the Business Loan and Investment Fund."

This depiction leaves someone not knowledgeable in the recent history of this program not only with the wrong impression that it is the Administration which has requested an increase in guarantee commitment but also with not even a hint that a crippling proviso has been attached to that authority.

This is the status of the program today. Unless the proviso is rescinded from the apportionment document, the program is dead. Soon, the small businesses may be.

What Else is Wrong with the Administration's Attack on this Federal Guarantee?

Why has the Administration so strongly opposed this Federal guarantee?

Part of the answer has now been given to us by Assistant Secretary Mehle and Assistant Director Kudlow.

Another part of the answer is found, I believe, in the November 5 White House's Office of the Press Secretary "Fact Sheet on Federal Credit/Loan Guarantee Reduction," and I quote:

> "The President today announced a program to reduce new Federal loan guarantee commitments for FY1982 by $20.3 billion, from $181.4 billion to $161.2 billion. The loan guarantee reductions are a part of the President's effort to relieve pressure on interest rates and to open the way for sustainable and non-inflationary economic recovery.
>
> "* * * the President's credit reduction proposal is designed to:
>
> "o Dampen inflation expections and lower interest rates.
> "o Provide the financial market equivalent of a $20 billion reduction in budget outlays * * *.
> "o Curtail the effects of government credit preemption from legitimate private enterprise.

"o Improve prospects for the expansion of productive investment and the recovery of economic growth.
"o Facilitate the appropriately restrained conduct of monetary policy.
"o Represent the first major effort to place substantial restraint on the off-budget explosion of Federal credit demand.

"* * * The Small Business Administration provides credit assistance to small businesses through its * * * 100% indirect guarantee of State pollution control bonds. Under this program, States issue tax-exempt pollution control equipment bonds and the SBA guarantees repayment of loans made to small businesses from the bond proceeds.

"The nearly $1 billion loan guarantee reduction (in SBA's total loan guarantee programs) planned by the President, a 20% reduction below the FY 1982 estimate of slightly less than $5 billion, will, as part of the economic program of lower tax rates, regulatory relief, and anti-inflationary monetary policy, afford more assistance to a wider variety of small businesses than the SBA programs, which focus on only a few. For instance:

" * * * The reduction in guarantee assistance will not have a significant adverse effect on SBA's ability to serve as a lender of last resort. It will merely eliminate assistance to those firms at the margin, i.e., those that could obtain credit without Federal assistance and those that would probably never become competitive even with Federal assistance."

Several comments are in order.

Most small businesses support the President's economic recovery program of reduced Federal spending, reduced corporate and individual taxes, reduced deficits and the crowding out of available capital and the inflationary pressures which deficits can generate, reduction in excessive and unnecessary regulation, and expanded export opportunities. I would think the percentage

of small businesses represented by the Coalition which support this economic recovery program would be little, if no, different from the percentage of small businesses as a whole.

The Coalition believes, however, that the November 5 OMB policy directive, as applied to the SBA pollution control facilties financing guarantee program, will continue to have consequences which may not, or should not, have been intended by the Administration.

We know that the concluding paragraph in the quoted sections of that November 5 Fact Sheet is simply wrong. Firms which have applied under this program have applied to SBA as, indeed, the lender of "last resort." Given the competition for these guarantees and the inadequate levels of annual authority, a small business would have known that it would not have reached "the top of the stack" unless it had exhausted private sector loan opportunities. Furthermore, it is not that a small business is marginal in the absence of indebtedness necessary to bring its plant into environmental compliance, it is, rather, that indebting itself further and substantially in order to assure that compliance is what makes the business either marginal or more marginal.

What the Administration is really articulating here is that Federal loan guarantees create "market distortions." It has failed to recognize something as equally important: So, too, do the requirements for expenditures to meet pollution control regulation by the acquisition and installation of generally non-

productive assets. As long as this Government's policy on the one hand is to have such pollution control reuglation, its policy on the other hand must be to assist businesses without private sector loan alternatives to finance the facilities and equipment required, and this means both the guarantee and the tax-exempt bond.

The Administration ignores something else just as egregiously. As I have already pointed out, small businesses going out of business will have adverse tax revenue loss and budgetary cost impacts too. Reduced corporate taxes paid and reduced Federal payroll taxes paid on one hand, and increased unemployment and other benefits on the other. Such economics is not only bad economics; it is also bad politics.

What Is To Be Done?

The questions today are whether this SBA program should be effectively abolished by the broad sweep of the broader Administration policy objectives and, if not, whether Congress intends to direct the Administration to end OMB's debilitating attack on small businesses and effective pollution control.

We believe that Congress must insist unequivocally that OMB proceed with $150 million in FY82 and $250 million in FY83 and in both years without the existing proviso proscribing reliance on tax-exempt bonds. That proviso now threatens the program's future as severely as does the restriction on annual authority; in some ways, even more so.

Summary

The Coalition believes OMB must allow SBA to proceed without this proviso. The case for this position is clear; the merits of this program are with it:

- The program actually makes money for the U.S. Government.
- The program has a nearly pristine actuarial integrity.
- The program does not interfere with capital markets.
- The program does allow equal access by small business to those capital markets.
- The program constituted less than 1% of the small IRB issues in FY81.
- The program has public benefits, particularly pollution abatement which are disproportionately high, compared to other IRB-financed projects.
- The program has one of the smallest administrative staffs on record.
- The program is funded with private sector funds, only guaranteed by the Federal Government.
- The program has benefited small businesses in more than thirty States, representing over 20,000 jobs.

The plea of this Coalition is more directed at the Administration than it is at this Congress, for the latter knows the merits. We hope the Administration comes to know them and to this end many of the small business applicants have joined in sending a letter to the President which we offer here to conclude our testimony.

The help of this Committee is crucial to assuring the right Administration response.

The Small Business Coalition for Pollution Control

President
Jack L. Schaefer
The Specialty Papers Company
Box 1031
Dayton, Ohio 45401
(513) 226-1300

Counsel
Randal C. Teague
Vorys Sater Seymour & Pease
1828 L Street, N.W.
Washington, D.C. 20036
(202) 822-8200

January 14, 1982

Hon. Roger W. Mehle, Jr.
Assistant Secretary for Domestic Finance
Department of the Treasury
Washington, D. C. 20220

Re: SBA Pollution Control Facilities Financing Guarantee Program
Taxable vs. Tax-Exempt Bond Issues

Dear Secretary Mehle:

The Small Business Coalition for Pollution Control was organized in 1981 to support the policy objectives of the Administration with respect to small businesses and to represent their interests before the Government in the referenced program. The Coalition has been involved actively in recent months in monitoring negotiations between OMB, Treasury and SBA with respect to the FY82 and proposed FY83 annual authority ceilings for this program and the terms and conditions attached thereto.

As you know, a compromise was reached during the closing hours of FY82 First Quarter, a compromise reached between OMB and SBA, the former with the advice of Treasury on one component of that compromise. The compromise is in two parts: the annual authority ceiling, which will be $150 million in FY82 and FY83, Public Law 97-92 notwithstanding, and the proviso requiring that the FY82 authority not closed as of the approximate date of the compromise and all the FY83 authority be available only for taxable bond issues. Because you have been involved in both the Federal loan and credit guarantees and the IDB tax exemption issues, we felt it particularly important to bring several matters to your attention.

This SBA program came into being for only one reason: small businesses could not obtain commercial financing of the expenditures required to comply with Federal air and water pollution control and solid waste management policies and orders without Federal guarantees of the bonds the proceeds of which are used for such facilities and equipment and without the added attraction within the bond marketplace of the tax-exemption.

These expenditures are compelled by Government policy; in the absence of that policy, the expenditures would not be made and the financing sought. If Federal loan and credit guarantees are a financial marketplace distortion, so too is the Government requirement that essentially non-productive control equipment be installed at great expense.

The tax-exemption of the bonds is compelled by the reality that the absence of that exemption would make the bonds, even aggregated, not

marketable. If tax-exempt bonds distort the capital pool, it is because the capital sought is mandated by Government environmental policy. If there is fear, well founded in our opinion, that tax-exempt bond issues cause tax revenue losses at a time when budgetary and monetary policy require reduction of those losses, it must be forever borne in mind in looking at this particular program that those losses are far less than the corporate income tax and personal income tax losses which are occasioned when the small businesses close down because the financing is not available.

This latter point is not an allusion to what might happen. Rather, it is a statement of what has happened. When the Administration put this SBA pollution control facilities financing guarantee program in abeyance in the Spring of 1981, there were better than 100 applicants. Some withdrew their applicants, hoping to persuade the environmental enforcement authorities that it was the same Government which had frustrated these companies abilities to comply with environmental standards. But something else, much more dramatic happened: some of these small businesses went out of business. The Coalition has compiled the names and statistical data on those companies.

Before one rushes to say that those small businesses which went out of business must have, therefore, been so marginal that they would not have survived anyway, reflect on the experiential history of this particular program: in its six years, there has never been a default not recovered by SBA. There have been only two defaults at all. There simply is no other Federal loan or credit guarantee program which has a default rate of less than one-fourth of one percent which has also then recovered all of the defaulted payments.

Our plea to you: to recognize the particular circumstances associated with this particular program, including that history and including why these small businesses need the Federal guarantees and the tax-exemption of the financing bonds, and to then do two things: (1) inform OMB, that is Lawrence Kudlow, that Treasury has no objection to rolling back the proviso requiring the remainder of the FY82 $150 million and all of the FY $150 million be available for only taxable issues, and (2) informing those within Treasury involved in the formulation of the Administration's position on the forthcoming Congressional hearings on industrial development bonds that, irrespective of what broader policies are sought, the tax-exemption for IDBs used for pollution control facilities under either IRC §103(b)(6)(E)-(F), solid waste and air and water pollution control facilities exemption or the IRC §103(b)(6)(A) small issue exemption ought to be preserved. We reference IRC §103(b)(6)(A) small issue exemption because a private sector business must use that exemption, rather than either IRC §103(b)(6)(E) or (F) because the latter must be for public purpose and other tests which a private corporation cannot meet. The entire history of this SBA program has been

one of using bonds under IRC §103(b)(6)(A).

The difference which taxable bond issues and tax-exempt bond issues have on these small businesses has been set forth in a recent letter to us from H. Robert Fuller of the First Wisconsin National Bank in Milwaukee, one of the four principal financial institutions involved in this program. The other three are Bank of America, Blyth Eastman out of the San Francisco office and McDonald & Co. investment bankers in Cleveland.

My only quarrel with the First Wisconsin depiction of the financial implications of the alternative between taxable and tax-exempt is that the applicants with which we are working indicate that the differential is closer to 4.25%, some 425 basis points.

Your attention to this matter and your involvement in its resolution would be very much appreciated.

Sincerely,

Randal C. Teague

RCT:ms
Enc.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

February 4, 1982

Dear Mr. Teague:

I am pleased to respond to your letter regarding the SBA pollution control facilities guarantee program.

In the last decade, rapid growth of Federal credit activity has had serious effects on the Nation's economy and on financial markets. For this reason, rigorous control over Federal credit programs has been and continues to be an important part of the President's budget reform plan. Greater control of these Federal programs is being accomplished by reducing their size and scope and by adopting legislative and administrative actions to decrease their impact on the capital markets.

In this regard, the Administration has maintained strong opposition to Federal guarantees of tax-exempt obligations, such as those obligations issued in conjunction with the SBA pollution control guarantee program. In a March 23, 1981 message to Congress, the President expressed his general opposition to federally-guaranteed tax-exempt obligations and the April 1981 "Additional Details on Budget Savings" specifically criticized the SBA pollution control guarantee program in this regard. The decision reached by OMB to only provide loan guarantees under the SBA pollution control program for taxable bond issues in fiscal years 1982 and 1983 results from this position.

Let me emphasize the reasons this Administration is strongly opposed to Federal guarantees of tax-exempt obligations. Placing the credit of the United States behind an obligation that is exempt from Federal taxation would create a security which would be superior in the market to the direct obligations issued by the U.S. Treasury. The Public Debt Act of 1941 prohibits the Federal Government from issuing tax-exempt obligations directly. It would therefore be contrary to the spirit of that Act to authorize the issuance of tax-exempt securities that are backed by the credit of the Federal Government.

Moreover, since the tax loss to the Treasury greatly exceeds the interest savings to the issuer of tax-exempt obligations, Federal guarantees of tax-exempts are a most inefficient means of providing Federal assistance.

The Administration is also concerned with the adverse effects of tax-exempt guarantees on the municipal market. Federal guarantees of tax-exempts create a security which is superior to all other tax-exempt securities issued by State and local government entities. Consequently, such guarantees add to the pressures on the municipal bond market, crowd out other, less creditworthy municipal borrowers, and increase the borrowing costs of all municipal borrowers.

I hope this information is helpful.

Sincerely,

Roger W. Mehle

Roger W. Mehle

Mr. Randal C. Teague
Vorys Sater Seymour & Pease
1828 L Street, N.W.
Washington, D.C. 20036

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

February 18, 1982

Mr. Randal C. Teague
Vorys, Sater, Seymour & Pease
1828 L Street, N.W. - Suite 1111
Washington, D.C. 20036

Dear Mr. Teague:

This is in response to your letter to Craig Fuller and me expressing the concerns of your clients about the Administration's policies regarding the Pollution Control Equipment Contract Guarantee Revolving Fund of the Small Business Administration (SBA).

As you indicate in your letter, a decision has been made to permit the guarantee of $150 million in pollution control loan or contract repayments during 1982. This decision, which results in a 1982 program level that is 50% higher than the 1981 actual level, was made with two caveats:

— First, that in view of the President's efforts to constrain Federal borrowing, the increase in guarantee authority for the pollution control program would be offset by a comparable reduction in other SBA credit programs.

— Second, that in view of the Administration's opposition to indirect Federal guarantee of tax-exempt bonds, the guarantees of repayments would be limited to loans or contracts that are financed from the proceeds of taxable bonds.

With respect to your allegation that this decision constitutes a violation of the law, I must strongly disagree. The Second Continuing Resolution for Fiscal Year 1982 (P.L. 97-92) did not "lock in" a $250 million program level for this Fund. In fact, the resolution did not provide statutory credit limitations for any of the SBA loan programs.

With respect to your concerns about the effect of the decision to discontinue the guarantee of loans financed from the proceeds of tax-exempt securities, I must also disagree. The combination of Federal guarantees with tax-exempt bonds increases the revenue loss to the U.S. Government while primarily benefiting the high-income purchasers of the bonds rather than small businesses. In addition, the Federal guarantee adds to the pressures on the municipal bond market by creating a security that is superior to all other tax-exempt securities issued by State and local governments. This could result in higher borrowing costs for State and local governments, which must finance schools, roads, hospitals, and other essential public facilities.

This Administration is continuing its efforts to alleviate Federal regulatory burdens that contribute to the high costs of operating small businesses. Where such regulations are necessary, we are attempting to ensure small business access to capital to comply with such requirements.

I hope that this response provides sufficient information for you to explain to your clients the reasons for the Administration's policies. Thank you for sharing their concerns.

Sincerely,

Lawrence A. Kudlow
Associate Director for
Economic Policy and Planning

cc: Craig Fuller

The Small Business Coalition for Pollution Control

President
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February 12, 1982

The President of the United States
The White House
Washington, D.C. 20500

Dear Mr. President:

We are small businesses whose abilities to provide jobs, produce goods and services, pay taxes and protect the environment have been consciously undermined in recent months by your Office Of Management and Budget's virtual destruction of the Small Business Administration's pollution control facilities and equipment financing guarantee program.

This letter is an urgent plea that you direct OMB to withdraw the unnecessary and probably illegal requirement it attached to the recent SBA apportionment document - that none of the remaining FY83 authority can be used to guarantee tax-exempt bonds. Those are the only bonds really available in the marketplace for financing these facilities and equipment.

Experts in this financial field are convinced that "taxable only" financing will effectively destroy the ability of numerous small businesses to finance compliance with government mandated pollution laws.

There is a profound inconsistency in the Government's administration of its environmental laws, and we are the small businesses caught in the middle of that inconsistency. On the one hand, we are being required to install environmental protection facilities and equipment to meet still-stringent EPA rules, and on the other hand, the OMB requirements eliminate the only effective means of obtaining loans required to install those facilities and equipment. Without this SBA program of "last resort" small businesses will be forced into noncompliance with environmental protection statutes, regulations, plans and orders. Or, into forced sales to bigger businesses with larger assets and borrowing leverage. Or, into insolvency if forced to overleverage against usually low net worth, because the uniqueness of these facilities and equipment leaves them without significant collateral values. Or, into shutdown.

We measure those dire, yet realistic, consequences against the experience of this program, SBA's most successful. It is that success which shows the lack of knowledge or interest at OMB.

No one in business knows the adverse impacts of the Federal Government spending and taxing and over-regulating more than a small business. Small businesses are the first hit by inflation. They are the first hit by crowding out and high interest rates. They are usually the first into economic slumps and the last out. This is why most small businesses, including those within the Small Business Coalition for Pollution Control, support your economic program of reduced spending, reduced corporate and individual income taxes, and reduced deficits. We support your attack on the crowding out of available capital and the inflationary pressures those deficits can create. We, too, seek reduced regulation and expanded export opportunities. But, OMB's broad policy objectives produce unintended consequences when applied to this SBA program.

OMB contends that the annual authority for this program must be rolled back to reduce Federal loan and credit guarantees in the capital marketplace. OMB contends, further, that the requirement prohibiting the program's association with tax-exempt bonds is necessary to prevent tax revenue losses.

OMB is wrong. This program constituted less than one percent of the small industrial revenue bond issues in 1981. It does not interfere with markets. The program has a nearly pristine actuarial integrity, with the only two defaults in its history now being recovered by SBA. The program actually makes money for the Government; its initial $15 million revolving fund has grown to over $30 million by the accumulation of the 3.5% fees paid by the applicants, and interest on that fund more than pays for all administrative costs. The program is funded with private sector funds; it is only guaranteed by the Government. The program has public benefits, particularly pollution abatement. Most importantly of all, it has benefited small businesses in more than 30 States, representing more than 20,000 jobs. If continued, the program will benefit many thousands more.

Mr. President, the "distortion" this program creates in the financial marketplace is miniscule compared to the real distortion caused by the Government requiring us to spend hundreds of millions of dollars on essentially non-productive facilities and equipment. Further, the tax revenue losses from

tax-exempt IRBs are miniscule compared to the real tax revenue losses which will result if we have to close our businesses and lay off our employees. Or, if we can't expand productive capacity. Absent a continuation of this program, as it existed prior to OMB's attacks upon it, that may happen to many of us. Bonds for our purposes simply cannot be marketed in the absence of the tax-exemption and the Federal guarantee.

Our case is clear. The merits of this program speak for themselves.

We ask you to direct OMB to reverse its unilateral actions and to do so before the matter worsens.

Respectfully requested,

Jack L. Schaefer
THE SPECIALTY PAPERS COMPANY
Dayton, Ohio

Steve Milter
NATIONAL BRIQUETTE CORPORATION
East Chicago, Indiana

Robert E. Embry
Baum Gardener Oil, Inc.
ENERGY RESOURCES,LTD.
Baltimore, Maryland

Robert Speach
ENV, INC.
Long Beach, California

James D. Lightbody
PHILWAY, INC.
Ashland, Ohio

Frank E. Smith
F. E. SMITH CASTINGS, INC.
Kingsford, Michigan

Fred Davino
PLATING FOR ELECTRONICS, INC.
Waltham, Massachusetts

Carl Hornby
ENVIRONMENTAL WASTE CONTROL, INC.
Inskster, Michigan

Craig Caine
AMERICAN FLY ASH COMPANY
Des Plaines, Illinois

Dennis O'Meara
OMEGA CHEMICAL CORPORATION
Whittier, California

Les A. Liman
DOWNHILL PICK-UP
Steamboat Springs, Colorado

J. E. Droege
ELECTROFILM, INC.
Valencia, California

Anthony L. Torrance
OPTICAL SCIENCES GROUP
Petaluma, California

Aubrey Burer
CHEMTRONICS
El Cajon, California

Larry Winget
Gary L. Robbins
VENTURE INDUSTRIES CORPORATION
Fraser, Michigan

W. O. Larson
M. F. Ludowese
LARSON CONSOLIDATED, INC.
Grafton, Ohio

Lewis Lakin
A. LAKIN & SONS, INC.
Chicago, Illinois

Harvey Scholten
RIVULET HURST DAIRY
Holland, Michigan

Leroy Wurst
HURON CASTINGS COMPANY
Pigeon, Michigan

Paul J. Keating
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P. J. KEATING COMPANY
Fitchburg, Massachusetts

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ALAN L. CHVOTKIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON SMALL BUSINESS
WASHINGTON, D.C. 20510

March 3, 1982

Mr. H. Norman Atkins
The Bond Market
3395 Northeast Expressway
Suite 300
Atlanta, Georgia 30341

Dear Mr. Atkins:

Thank you for your letter, and your comments on the Small Business Administration's Surety Bond program. I appreciate having your comments on the proposed budget reductions, as well as the programatic changes that have been proposed.

The Senate Small Business Committee held a hearing on Feb. 23 to review the Small Business Administration's fiscal year 1983 budget submission. I have asked that your statement be included in the record of that hearing. In addition, your comments will be particularly useful to the Committee as we consider the SBA fiscal year 1983 budget.

Thank you again for you comments on the Surety Bond Guarantee Program. Please do not hesitate to contact me again if I can be of any further help on this or other issues that concern you.

Sincerly,

Sam Nunn

The Bond Market, Inc.

SMALL BUSINESS ADMINISTRATION SURETY BOND GUARANTEE PROGRAM

AUTHORITY: Title IV Part B of the Small Business Investment Act of 1953, 84 Stat. 1812; 15 U.S.C. 694a, 694b, 694c.

STATUTORY PROVISIONS: The relevant statutory provisions will be found at 15 U.S.C.S. 694(a) et seq. (as amended).

POLICY: It is the intent of Congress to strengthen the competitive free enterprise system by assisting qualified small business concerns to obtain certain bid, payment or performance bonds that are otherwise not obtainable, by authorizing SBA to guarantee surety companies up to 90 percent of their losses incurred by reason of the breach of the terms of such bonds executed on behalf of such concerns on contracts not exceeding a contract amount of $1,000,000.00.

IT IS WITH THIS POLICY IN MIND THAT I APPEAL TO YOUR PUBLIC CONCERN.

Although the Surety Bond Guarantee Program was adopted in 1972, it was not until December, 1976 that the figures were computerized and stored. From the time that this data was first kept, until January 31, 1982, the Surety Bond Guarantee Program produced nationally, guarantees on contracts awarded to small contractors in excess of 10.6 billion dollars with a loss ratio of less than 1.83%. It should be noted here that included in these figures are contracts awarded to Georgians amounting in excess of 456 million dollars. There is no loss ratio available on these Georgia contracts, however, Region IV of the Small Business Administration, which encompasses Florida, Georgia, North Carolina,

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South Carolina, Tennessee, Kentucky, Alabama and Mississippi, experienced a loss incurred percentage of approximately 1.72%; less than the national average.

These figures should lend themselves to the magnitude, scope and necessity of the Small Business Administration Surety Bond Guarantee Program, since the majority of all publicly funded contract work (e.g. Federal, State, County and City) requires contractors to seek these jobs by competitive bidding. These contractors must be bonded according to statute in the bidding phase, as well as during the actual construction.

Since the outset of the Small Business Administration Surety Bond Guarantee Program, the long range objective, that of helping the small contractor become more bondable in their own right and without the need of an SBA bond guarantee, has been demonstrated time and time again by graduating those that have proven themselves into the available standard surety markets.

President Reagan, in a letter dated October 18, 1980 to the American Special Surety Council, recognized the value of the Small Business Administration Surety Bond Guarantee Program and was pleased the government is using the private sector to attain program goals.

> "This latter arrangement is entirely consistent with my policy to strengthen the role of the private sector, particularly small business, in order to increase jobs and cut the rate of growth in federal spending."

There were certainly many abuses within the program in its inception, but over the years it has become the most beneficial

and advantageous program available to the private sector through the Small Business Administration.

It appears that because of "Reaganomics" this program has been selected as one of many that must suffer a decisive reduction in the current and future budget allocations. This has been very recently demonstrated by Michael Cardenas, the previous Administrator of the Small Business Administration, when he imposed unrealistic, preposterous parameters that currently must be met. To quote his recent communique of January 18, 1982, "budgetary considerations have again necessitated a review of Surety Bond Guarantee Program levels, and a restatement of underwriting requirements which have a direct effect on those levels." By imposing two major policy changes in January, 1982, he may have, with one "wave of his hand", condemned most small contractors to insolvency.

Since the inception of this program, the contractor, as well as the participating surety, have encountered numerous amendments to the original conception, some favorable, some others unfavorable, but, in general, regulations that do allow contractors to actively participate in competitive construction bidding. With the current major changes in policy, the contractor has now been limited in growth by reducing the size of an SBA guarantee to a maximum of $250,000.00 for any single contract or combination of contracts for the same contractor on a single project. Prior to January, 1982, the contractor, if qualified, could participate in a single contract of up to $1,000,000.00. In addition, the second major change now allows the contractor to grow by no more than 125% of his largest previously completed contract as opposed to standard

guidelines offered by standard surety companies, growth of 200% of his largest previously completed job. Allowing a contractor to bid only 125% of the largest previously completed contract indicates that he/she may actually be losing ground, taking into consideration the extremely high inflation rate of labor and materials of the past few years.

A few months ago I referred to a decisive reduction in the current and future allocations - from 1.6 billion to 1.4 billion by the Government Fiscal Year-end 1981 and further reductions from 1.4 billion to 1.08 billion by the Government Fiscal Year-end 1982. The fund created within the Treasury for this program is clearly stated as a revolving fund and is not being administered as such, causing these cutbacks to be paralyzing to the Small Business Administration Surety Bond Guarantee Program.

It is very possible that if the revolving fund was being administered as was intended by Congress, the current reduction in budgetary allocations may be digestible. That is to say, if the Small Business Administration would recognize the final release given them by the participating surety company and allow those funds to be reused on future guarantees, it may even be feasible to penetrate the budget still further. This is, however, not the case. The Small Business Administration Surety Bond Guarantee Program is currently debiting against their budgetary allocations their percentage of the contract guaranteed (80 or 90%) and upon notification by the surety of final completion of the said contract, consider the money "spent", never to be used again.

It is one thing to reserve an anticipated loss, but to dispose of the funds set aside on a contract that has been completed, where no further liability exists to the Small Business Administration, is ludicrous.

Taking into consideration ever increasing costs of construction and the current method of administering the fund, it should be obvious that regardless of the allocations for this program, there will never be sufficient funds to accommodate the needs of the small contractor in this program.

Since the Federal Government encourages the small business-person to participate in Federal Construction projects, as evidenced by the SBA 8(a) Program and the SBA Set-Aside Program, I can't help but find amusement in the fact that in order to be awarded any of those contracts the contractor must first furnish a Performance/Payment bond to guarantee his work.

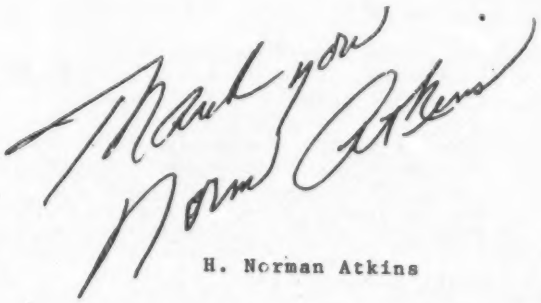
Several years ago, the merits of the Small Business Administration Surety Bond Guarantee Program were being challenged. Statistics gathered by Congressional subcommittees showed an overwhelming savings when publicly funded entities were able to award projects to small business contractors, bonded through the facilities of the Small Business Administration Surety Bond Guarantee Program. These savings were realized due to the fact that small contractors were able to pass their lower overhead costs in their bid prices, as opposed to larger contractors with higher overhead and operating expenses.

It may be well to note that a recent comment made by the senior underwriter of one major convention market praised the

Small Business Administration Surety Bond Guarantee Program as a way of educating small contractors to the professional requirements needed to graduate into the Standard Surety Market. He also affirmed that my agency alone has graduated over 16 contractors into his realm of suretyship.

As we know, it has become a mandatory requirement by the Federal Government that large percentages of minority contractors participate in federally funded grants, such as the Metropolitan Atlanta Rapid Transit Authority, but how can these quotas be met without the aid of the Small Business Administration Surety Bond Guarantee Program, since all construction contracts must be bonded.

The time is now when elected officials should examine the impact that <u>any</u> budgetary reduction or <u>any</u> stringent underwriting requirements may have had, or will have in the future, on the citizens of our State generating a livelihood in one of the largest industries of our country,.....Construction!



H. Norman Atkins

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